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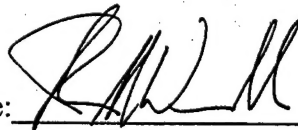
11 March 1999

**Competitive Sourcing--A Critical Component of DoD's Force  
Modernization Program**

by

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A paper submitted to the faculty of the Naval War College in partial satisfaction of the requirements of the Advanced Research Department. The contents of this paper reflect my own personal views and are not necessarily endorsed by the Naval War College or the Department of the Navy.

Signature: 

11 March 1999

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## Abstract

The Quadrennial Defense Review (QDR), the Defense Reform Initiative (DRI), and new Congressional legislation call for a Revolution in Business Affairs (RBA) within the Defense Department. A major element of this revolution is the competitive sourcing of appropriate DoD commercial activities. This initiative draws upon the competitive forces of the private sector to generate substantial savings to support the ambitious modernization program detailed in the Future Years Defense Program (FYDP).

DoD expects the combined results of the QDR and DRI to produce \$6.5 billion in annual savings, of which, \$2.5 billion is slated to come from competitive sourcing. This research indicates that competitive sourcing alone has the potential of nearly satisfying the entire DRI savings goal. Using a conservative estimation methodology, competitive sourcing can yield about \$5 billion in annual savings towards the DRI goal. If more aggressive strategies are employed, and combined with effective competitive sourcing techniques, estimates of annual savings approach \$6 billion. Competitive sourcing offers DoD a powerful means to reduce program risk inherent in the FYDP.

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**Background** The Quadrennial Defense Review (QDR) Report, issued in May of 1997, and the Defense Reform Initiative (DRI) call for a “Revolution in Business Affairs” (RBA) to underwrite force modernization during the Future Years Defense Program (FYDP).<sup>1</sup> Designed to produce internal Defense Department savings, this RBA has been necessitated by a defense budget with a fixed “top-line”. As a result of the Balanced Budget Agreement, the defense budget is not likely to increase significantly in the short- to mid-term, and could even decline.<sup>2</sup> DoD has adopted a strategy that seeks reductions in infrastructure, support functions, and personnel to substantially increase funding for force modernization. A central element of this strategy is the *competitive sourcing*<sup>3</sup> of non-core defense functions. Competitive sourcing draws upon the competitive forces of the private sector to generate “efficiency savings”, and will certainly occupy a prominent position across the FYDP landscape.

**Problem** The potential impact of competitive sourcing has proven extremely difficult to estimate with any precision. Shifting baselines, uncertain resources, moving targets, political uncertainty, official optimism, and conflicting guidance have confounded attempts to predict the range of savings possible.

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<sup>1</sup> The Future Years Defense Program is a five-year program from FY 1999 to FY 2003.

<sup>2</sup> Department of Defense, Report of the Defense Science Board Task Force on Privatization and Outsourcing (Washington: 1996), 1A.

<sup>3</sup> The *outsourcing* initiative within DoD is now commonly referred to as *competitive sourcing*. *Competitive sourcing* emphasizes competition that enables “right-sourcing”. The new title removes an implied bias towards outsourcing as the ultimate goal of competition.

The potential of competitive sourcing has been described in terms that range from funereal pessimism to unbridled optimism. Listed below are several positions taken by organizations and officials that are actively involved in the ongoing debate:

Report of the Defense Science Board Task Force: The Defense Science Board (DSB) Task Force on Outsourcing and Privatization, under the auspices of the Under Secretary of Defense for Acquisition and Technology (USD(A&T)), concluded that "all DoD support functions should be contracted out to private vendors except those functions which are inherently governmental, are directly involved in warfighting, or for which no adequate private sector capability exists or can be expected to be established."<sup>4</sup> The DSB final report points to cost savings as an important source of momentum for the outsourcing movement, but states that "cost savings" are not (and should not be) the primary objective of outsourcing. Access to better technologies and better qualified people are the principal objectives that should ultimately lead to an enhanced, more efficient DoD support structure. The DSB determined that an ambitious outsourcing program could potentially lead to more than \$10 billion in annual savings by Fiscal Year (FY) 2002.<sup>5</sup>

General Accounting Office Reports: The General Accounting Office (GAO) has been extremely critical of DoD's ambitious outsourcing blueprint. GAO points to DoD's demonstrated inability to realize projected savings from several previous initiatives. The projected savings, they claim, have been calculated using overly optimistic assumptions. Moreover, GAO makes an historically-based argument that DoD has not been able to shift funds from non-mission or infrastructure programs to modernization programs.<sup>6</sup> GAO goes so far as to say that DoD's ability to execute the FYDP budget (FY 1999-FY 2003) is at considerable risk.

Center for Naval Analyses Studies: The Center for Naval Analyses (CNA) has produced qualitative and quantitative reports that are beginning to constitute a meaningful body of "corporate knowledge" for DoD outsourcing programs. CNA projects that outsourcing savings will exceed \$6 billion annually before the end of the FYDP.<sup>7</sup>

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<sup>4</sup> Memorandum for the Chairman of the Defense Science Board, "Final Report of the Defense Science Board Task Force on Outsourcing and Privatization," 27 August 1996.

<sup>5</sup> Memorandum for the Under Secretary of Defense (Acquisition and Technology), "Final Report of the Defense Science Board Task Force on Outsourcing and Privatization," 28 August 1996.

<sup>6</sup> Richard Davis, "Statement," U.S. Congress, Committees on National Security, Military Procurement, and Defense Department Modernization, 8 October 1998.

<sup>7</sup> Center for Naval Analyses, Bidding Behavior in DoD's Commercial Activities Competitions (CRM 97-68), (Alexandria, VA: 1998), 2.

Business Executives for National Security (BENS):<sup>8</sup> The BENS "Tail-to-Tooth" Commission has attacked DoD's "wasteful" support structure as a drain on resources – resources that should be used to support the warfighter.<sup>9</sup> A recent BENS report describes DoD as "one of the last of the industrial pyramids" dating back to the early years of the Cold War; a time when DoD had no choice but to develop in-house expertise. BENS contends that outsourcing could be conducted on a large-scale for non-core activities with "zero impact on DoD's core mission of military readiness."<sup>10</sup> BENS reports suggest that cost savings exceeding \$2.5 billion annually are possible through aggressive outsourcing.

The Center for Strategic and Budgetary Assessments (CSBA): In a recent CSBA study, outsourcing is described as a credible vehicle to bring about substantial "efficiency savings". The report recommends the aggressive outsourcing of various support functions. However, the report cautions DoD against relying too heavily on these efficiency savings due to the uncertainty of their effectiveness.<sup>11</sup> CSBA analysts conclude that the long-term feasibility of DoD budget execution should not *depend* on outsourcing savings.

The American Federation of Government Employees (AFGE): The AFGE opposes outsourcing and related legislation that would, in their estimation, "put the government up for sale over the next five years."<sup>12</sup> In testimony before a joint committee of the Senate and House, the AFGE President claimed that Congress is trying to "sell off" the government, charging that the outsourcing initiative "is not about saving taxpayer dollars, [rather] it's about privatization at any cost."<sup>13</sup> The AFGE contends that it has not yet been proven that competitive sourcing actually saves *any* money. The AFGE reported that Pentagon officials are not optimistic that planned competitions will yield the savings—savings that they admit have been "overestimated".<sup>14</sup>

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<sup>8</sup> BENS is a national organization of nonpartisan business leaders that enjoy the strong support of influential government leaders, to include: Secretary of Defense William Cohen, former Senator Sam Nunn, and Senator Richard Lugar. BENS has established the BENS "Tail-to-Tooth" Commission to promote major changes in DoD business practices by advising those who act in the Congress, the Pentagon, and the White House. BENS has focused on reversing the current ratio of "warfighting to support" activities ("tooth-to-tail") which it believes is 30% to 70%.

<sup>9</sup> Business Executives for National Security, BENS Tail-to-Tooth Commission Briefing Book (Washington: 1998), 8.

<sup>10</sup> Thomas G. McNerney and Erik R. Pages, "Bolstering Military Strength by Downsizing the Pentagon," Issues in Science and Technology, winter 1997-1998.

<sup>11</sup> Center for Strategic and Budgetary Assessments, Cost of Defense Plan Could Exceed Available Funding by \$26 Billion a Year Over Long Run (Washington: 1998), 2.

<sup>12</sup> American Federation of Government Employees (AFGE) Bulletin, Vol. 14, No. 2, March-April 1998, p1. <<http://www.afge.org/bulletin/B-v14n02.htm>>

<sup>13</sup> Ibid.

<sup>14</sup> AFGE Fax/Newsletter, 1 May 1998, 1. <[www.afge.org](http://www.afge.org)>

The Annual Report (1998) of The Secretary of Defense to the President and Congress: "Competition is the driving force in the American economy. It forces organizations to improve quality, reduce costs, and focus on customers' needs. Competition offers these same benefits to DoD and plays a critical role in the reform effort. U.S. bases and forces require support in a number of service areas. Buildings must be maintained; equipment must be repaired; checks must be written. Many of these activities are now performed by uniformed personnel or civilian government workers. Often, there is no reason why this work cannot be performed by the private sector. In such cases, following the example of America's leading firms, DoD will benefit greatly by introducing the dynamic forces of competition into the procurement of support activities."<sup>15</sup> The Office of the Secretary of Defense (OSD) expects the combined results of the QDR and DRI to produce \$6.5 billion in annual savings, of which, \$2.5 billion will come from outsourcing.<sup>16</sup>

These divergent positions establish a wide range of potential savings for competitive sourcing. The DSB estimates that savings can grow to \$10 billion annually by FY 2002. The CNA sees potential for annual savings of \$6 billion by FY 2003. Both DoD and BENS believe a more modest annual savings estimate of \$2.5 billion is achievable. Lastly, the AFGE questions the validity of *any* estimates of cost savings.

**Research Goal** This research evaluates the potential of competitive sourcing within a practical framework of existing constraints and limitations, and draws upon the results of previously conducted outsourcing studies. Conclusions are presented that establish reasonable expectations for the future contribution of competitive sourcing to the realization of force modernization funding goals over the FYDP and beyond.

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<sup>15</sup> Chapter 16, "Defense Reform," The Annual Report of The Secretary of Defense to the President and Congress, 1998. <<http://www.dtic.mil/execsec/adr98/chap16.html#top>>

<sup>16</sup> These numbers were based on DoD's plan calling for the review of 237,196 jobs for competitive sourcing.

## BACKGROUND

*Outsourcing and Privatization defined* Outsourcing and Privatization (O&P) are receiving top-billing in the rush to reform DoD business practices under the DRI. The term "outsourcing" refers to the transfer of a support function traditionally performed by an in-house organization to an outside provider. Outsourcing occurs in both the public and private sectors. Successful outsourcing arrangements leverage superior technologies and business practices to improve service delivery and reduce support costs. Vendors are usually selected as the result of a competition among qualified bidders.<sup>17</sup>

The term "privatization" is a subset of outsourcing, and applies only to the public sector. Privatization actions not only involve the contracting out of support functions, but also the transfer of facilities, equipment, and other government assets to private vendors. Government organizations often outsource support functions without privatizing public assets. This paper focuses primarily on the broader concept of outsourcing which includes privatization.<sup>18</sup>

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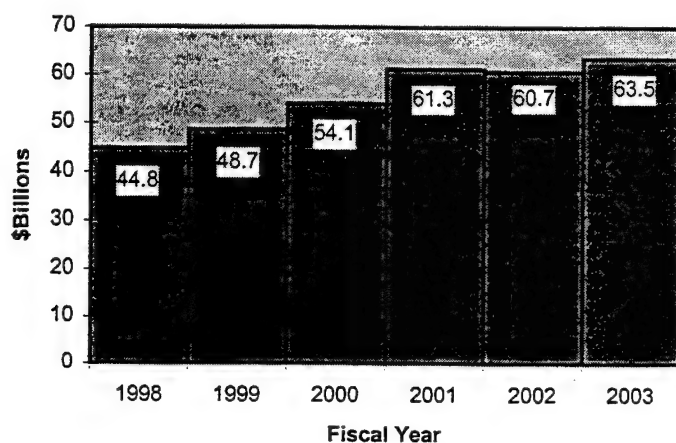
<sup>17</sup> Department of Defense, Report of the Defense Science Board Task Force on Privatization and Outsourcing (Washington: 1996), 7A.

<sup>18</sup> Ibid.



**Modernization Funding** DoD is currently facing a modernization dilemma, and many would argue a “*crisis*”. Procurement funding is programmed to increase by more than 40 percent over the FYDP (from \$44.8 billion in FY 1998 to \$63.5 billion in FY 2003).<sup>19</sup>

(Figure 1) Procurement Funding



The 1997 Balanced Budget Agreement holds the Defense budget “top-line” in place for the foreseeable future. As a result, DoD internal savings must grow along with procurement funding increases (Figure 1) to at least \$18.7 billion per year by FY 2003 to fund the ambitious FYDP modernization program. Stated another way, cumulative internal savings of approximately \$64 billion are required to fund procurement growth from FY 1998 to FY 2003.

The Defense Department’s response to this fiscal challenge is that the combination of (1) Base Realignment and Closure (BRAC); (2) decreased Research, Development, Test, and Evaluation (RDT&E) funding requirements; (3) lower than

<sup>19</sup> Appendix B, “Budget Tables,” The Annual Report of The Secretary of Defense to the President and Congress, 1998; Table 33-1, “Budget Authority by Function, Category, and Program,” The Fiscal Year 1999 Budget Proposal for the U.S. Government, <<http://www.fas.org/man/docs/fy99/budget/261-335.htm>>

anticipated inflation; and (4) QDR/DRI savings will amount to roughly \$20 billion per year by FY 2003, thus adequately offsetting the modernization shortfall over the FYDP. Defense budget planners estimate that competitive sourcing will contribute over 12 percent of the required annual savings (\$2.5 billion).

The contributions of the four sources of internal savings are:

**BRAC** Past BRAC rounds (1988, 1991, 1993, and 1995) will provide roughly \$13.5 billion in cumulative savings between FY 1998 and FY 2001. Thereafter, BRAC savings from these completed BRAC rounds will produce steady state savings of \$5.6 billion annually.<sup>20 21</sup> Future BRAC rounds have been proposed, but not yet approved.

**RDT&E** A generation of new systems is moving from RDT&E into production during the FYDP. As a result, resources within the Defense budget can be shifted gradually from RDT&E into procurement accounts. Decreasing RDT&E budget authority from FY 1999 to FY 2003 will produce a cumulative savings of \$12 billion, or annual savings averaging about \$2.4 billion.<sup>22</sup>

**Inflation** Inflation savings from the FY 1998 budget appear to be over-estimated. DoD's current (adjusted) inflation estimates project a cumulative "windfall" savings of \$20 billion from FY 1999 to FY 2003. Under provisions of

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<sup>20</sup> Paul Taibl, "The \$60 Billion Modernization Goal: What, When, How Risky?" BENS Tail-to-Tooth Commission Briefing Book (Washington: 1998), 4.

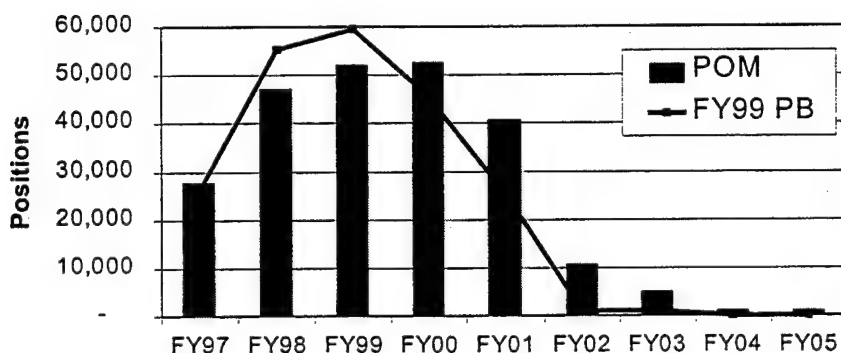
<sup>21</sup> These estimates of BRAC savings do not incorporate any costs or savings from possible future BRAC rounds.

<sup>22</sup> Table 33-1, "Budget Authority by Function, Category, and Program," The Fiscal Year 1999 Budget Proposal for the U.S. Government. <<http://www.fas.org/man/docs/fy99/budget/261-335.htm>>

the Balanced Budget Agreement, DoD would retain any windfall savings resulting from lower inflation.<sup>23</sup>

**QDR/DRI** The DRI is expected to yield \$6.5 billion annually to the funds available for modernization. DRI-driven force reductions, privatization of government housing, acquisition streamlining, transportation and travel reform, and various other business reforms are expected to contribute \$4 billion of the \$6.5 billion. The remaining \$2.5 billion is expected to come from an aggressive competitive sourcing program that opens 237,196 full time equivalents (FTEs)<sup>24</sup> for competition over the FYDP.<sup>25</sup> Figure 2 shows both the FY 1999 Program Objective Memorandum (POM)-based competition plan, and the FY 1999 Program Budget (PB) competition schedule.

(Figure 2) **DoD Programmed Competitions**



<sup>23</sup> Paul Taibl, "The \$60 Billion Modernization Goal: What, When, How Risky?" BENS Tail-to-Tooth Commission Briefing Book (Washington: 1998), 4.

<sup>24</sup> A given amount of work can be done by any mix of full-time and part-time personnel. By describing the work in standard terms, i.e., Full Time Equivalents (FTEs), fair comparisons can be made during the competition process. FTEs are equal to one work-year for a given job. DoD competes based on FTEs, not positions.

<sup>25</sup> Interview with a representative from the Deputy Under Secretary of Defense (IA&I) Competitive Sourcing and Privatization Office, December 1998. The 237,196-billet target is based on a compilation of the POM submissions to OSD.

Assuming that DoD can make good on all the savings described above, more than \$63 billion will be saved (from FY 1998 to FY 2003), roughly matching the \$64 billion required. For this reason, the USD(A&T), Jacques Gansler, stated that the Pentagon did not need a top line increase to reach its \$60 billion procurement goal, if it undertook the acquisition reform measures associated with the DRI.<sup>26</sup>

There is, however, a serious risk that the costs of modernization have been underestimated, and that internal savings have been over-estimated. There are several sources of risk that must be identified and considered.

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<sup>26</sup> Frank Wolfe, "Gansler: Pentagon Should Move to Price-Based Acquisition," Defense Daily, 3 December 1998, 2.

## MODERNIZATION RISKS

**BRAC** Savings from past BRAC rounds represent a source of reliable and predictable internal cost savings. Future BRAC rounds have not yet been factored into any DRI cost/savings calculations. Contrary to popular thinking, future BRAC rounds will not generate near-term savings, but in fact, will increase short-term costs. The basic difficulty with BRAC's economic attractiveness is that money to close installations must be spent for five to six years (and longer, in some cases) after the installation is slated for closure. For example, many bases require expensive and time-consuming environmental clean-up before they can be properly termed assets.<sup>27</sup> Experience shows that closing bases will increase costs for each of the first three years. Even if Congress becomes more inclined to accept the two BRAC rounds being proposed, those closures would probably not begin to pay for themselves until well after the QDR time frame of 2015.<sup>28</sup>

In addition to BRAC's short-term economic costs, it remains a heavy political liability for public officials. Closing military bases is extremely unpopular in Congress, where legislators are reluctant to further antagonize their constituents who have already suffered considerably during previous rounds of closures.

**Unrealized Inflation and RDT&E Savings** DoD's revised inflation predictions are considerably lower than the inflation estimates derived by both the Office of

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<sup>27</sup> Interview: Lane Pierrot, "Budget Duo Question Defense Spending Plan," Defense Week, 15 December 1997, 2.

<sup>28</sup> J. M. Brower, "The QDR and the National Defense Panel Report—Concerns for Resource and Financial Managers," Quadrennial Defense Review Update Information Paper, July 1996, 4.  
<<http://www.asafm.army.mil/rabp/infopap/qdrmdp.htm>>

Management and Budget (OMB) and the Congressional Budget Office (CBO).<sup>29</sup> This means that DoD estimates of inflation rate savings may be too high. DoD's methodology has been called into question by both OMB and CBO. Unrealized RDT&E savings may not materialize due to delays or technical problems that traditionally have plagued the development of advanced weapon systems that integrate sophisticated new technologies. When delays are not acceptable to Defense officials, program costs can increase exponentially to safeguard development and production schedules.

*Increased Costs for Weapon Systems* Recent CBO and CSBA assessments are skeptical of DoD's accuracy in pricing its new generation of weapons systems.<sup>30</sup> DoD's estimates of modernization costs might be reasonable if the Department were willing to accept some reductions in capability. However, DoD generally expects the systems it purchases to represent improvements over their predecessors. The CSBA states that the modernization costs associated with the FYDP will exceed the "assumed long-term funding level" by \$26 billion per year.<sup>31</sup> Production of the following new weapon systems has been cited by the CSBA as significantly contributing to this shortfall: the F-22, F/A-18E/F, Joint Strike Fighter (JSF), New Attack Submarine (NSSN), DD-21 surface combatant, and the Comanche Helicopter. According to the CSBA, many of these systems will cost twice as much or more to procure than the weapon systems they are replacing.

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<sup>29</sup> Paul Taibl, "The \$60 Billion Modernization Goal: What, When, How Risky?" BENS Tail-to-Tooth Commission Briefing Book (Washington: 1998), 5.

<sup>30</sup> Center for Strategic and Budgetary Assessments, Cost of Defense Plan Could Exceed Available Funding by \$26 Billion a Year Over Long Run (Washington: 1998), 1.

<sup>31</sup> Ibid.

CSBA analysts believe that DoD has several alternate strategies to effectively mitigate this funding dilemma. One of these options consists of deep cuts in modernization funding, but no cuts in force structure. Another option recommends deep cuts in force structure, but no cuts in modernization. CSBA presents two additional alternatives that combine various aspects of the first two strategies. Inherent in the CSBA recommendations is a recognition that something has to be sacrificed in order to operate within the defense budget cap, and that some "acceptable" risk can be assumed over the short-term to allow for these sacrifices. What is less clear from this argument is its long-term applicability and adequacy.

***Unprogrammed Expenses*** DoD's plans to cut the Operating and Maintenance (O&M) budget have been stymied annually since 1993 because unprogrammed contingency operations have siphoned-off funding. During recent years, unprogrammed operating expenses have caused the migration of \$15 billion annually from modernization accounts. Other categories of unprogrammed expenses include: depot maintenance, real property maintenance, health care, weapon systems' growth, military construction, and minor procurement.<sup>32</sup>

***New Program Demands*** The following new programs are not currently budgeted and will not fall into the "emergency" appropriations category: National Missile Defense (\$3 billion); NATO Enlargement (\$1 billion); and maintaining nuclear

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<sup>32</sup> The Secretary of Defense has submitted a request for "emergency" contingency funding outside the DoD budget to preclude unprogrammed operations from draining the defense budget in the future.

forces at Start I levels if Start II Treaty is not ratified (\$5 billion).<sup>33</sup> These programs may impede DoD's current plan to generate internal savings.

***Quality of Life and Retention*** Improving the Quality of life (QOL) for service members and their families has become a top priority for Secretary of Defense Cohen. The service chiefs currently view QOL issues as directly influencing their decreased ability to retain quality personnel. As a result, a higher demand for internal funding is now being felt to satisfy the immediate requirement to deliver on promised increases in pay and retirement benefits to redress the growing gap between military and civilian workers.

***Estimating Risk*** The Technical Director of the BENS Tail-to-Tooth Commission believes that DoD's poor track record of converting good ideas into actual savings requires an aggressive 4-to-1 ratio of planned savings-to-expected savings. He states that "...if they [DoD] absolutely, positively have to have \$15 billion more for modernization, they need to program \$60 billion of defense reform savings. To date, they have only accounted for \$20 billion—and, with the possible exception of BRAC savings, it is all at risk of not being fully realized."<sup>34</sup> It is impossible to estimate the degree to which demands on defense resources will exceed the projections; but the risk of that eventuality is considerable. It is clear, therefore, that DoD needs to maximize defense reform savings to hedge against inherent program risk.

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<sup>33</sup> Paul Taibl, "The \$60 Billion Modernization Goal: What, When, How Risky?" BENS Tail-to-Tooth Commission Briefing Book (Washington: 1998), 7.

<sup>34</sup> Ibid.



## THE DYNAMICS OF COMPETITIVE SOURCING

*"When the pace of change outside an organization becomes greater than the pace of change inside the organization, the end is near."*

President, AT&T

*"Competition is the driving force in the American economy. It forces organizations to improve quality, reduce costs, and focus on customers' needs. Continuously spurred by these forces, American firms are now global leaders in innovation, cost performance, and technological development."*

Deputy Secretary John Hamre - ...

The first question to be addressed is whether history gives us reason to believe that DoD can obtain large savings through competitive sourcing. The vast majority of data overwhelmingly indicate that the answer is "yes". A RAND study found that 15 to 45 percent savings were achieved by competing motor vehicle maintenance functions.<sup>35</sup> Another RAND study concluded that 15 percent savings were realized through the outsourcing of undergraduate pilot training in the Air Force.<sup>36</sup> A Logistics Management Institute (LMI) study determined that 27 percent savings were gained by contracting-out housing maintenance.<sup>37</sup> A Brookings study reported savings of 40 percent for laundry, custodial services, and refuse collection activities.<sup>38</sup> The results of all CNA competition and outsourcing studies demonstrate savings that generally fall within a range of 20 to 50 percent.

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<sup>35</sup> Ross Stolzenberg and Sandra Berry, A Pilot Study of the Impact of OMB Circular A-76 on Motor Vehicle Maintenance Cost and Quality in the U.S. Air Force, (RAND: 1985).

<sup>36</sup> Robert M. Paulsen and Arnold Zimmer, An Analysis of Methods of Base Support: Contractor Operations Versus Standard Operations at Two Undergraduate Pilot Training Bases, (RAND: 1975).

<sup>37</sup> John B. Handy and Dennis J. O'Connor, How Winners Win: Lessons Learned From Contractor Competition in Base Operations Support, (Logistics Management Institute: 1994).

<sup>38</sup> Martin Binkin, Herschel Kanter, and Rolf Clark, Shaping the Defense Civilian Workforce, (The Brookings Institute: 1978).

Previous research indicates that the primary source of savings is competition itself; and as the private sector has demonstrated time and time again, competition is also the primary catalyst for efficiency gains. Competition provides customers with alternate sources from which to choose, thus serving to effectively control costs and improve quality. Competition makes all relevant costs visible to those who are serious about winning, and are viewed as primary drivers of the price of goods or services rendered in a market economy.

*The following discussion provides the empirically-derived findings of previously conducted analyses of competition data:* Beginning in 1993, the CNA conducted numerous studies that analyzed the available DoD competition data from 1978 to 1994. What surprised many, was the fact that the in-house team won about half of all competitions.<sup>39</sup> When the in-house team won, savings still averaged an impressive 20 percent. Through these studies, the CNA determined that about 85 percent of all savings could be directly attributed to the dynamics of competition itself.

*CNA studies of A-76 competitions completed between 1978 and 1994 produced the following results:*<sup>40</sup>

- 1) DoD experienced average savings from competition of 31 percent. This calculation of average savings includes all competition data available

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<sup>39</sup> Center for Naval Analyses, Outsourcing and Competition: Lessons Learned From DoD CA Programs (Alexandria, VA: 1996), 6.

<sup>40</sup> Ibid., 9.

regardless of whether the in-house team retained the work, or the work was outsourced.

- 2) Savings averaged 20 percent when the “in-house” team won.
- 3) Savings averaged 40 percent when private contractors won.

***Competing military billets increases savings.*** About 36 percent of the DoD Commercial Activities (CA) inventory consists of military personnel.<sup>41</sup> The outsourcing of military billets is very attractive for two reasons: 1) Competing functions performed by military personnel yields the highest savings—50 percent on average.<sup>42</sup> 2) Formal A-76 studies may not be required, and direct conversions can be executed when enlisted ratings or officer designators are eliminated. So although there can be significant ramifications when military billets are outsourced, 60 percent higher-than-average savings can be achieved.

***Larger contracts produce higher rates of savings.*** Table 1 illustrates the relationship between *savings* and *size* of competitions. Savings increase modestly with contract size. The table also shows that the vast majority of contracts are small (fewer than 30 billets). The evidence clearly encourages the competing of bundled functions to increase the number of billets included in each contract. Despite the economic attractiveness of large,

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<sup>41</sup> This percentage was taken from the FY 1995 CA inventory data under the assumption that it generally holds true for the current CA inventory.

<sup>42</sup> The CNA argues that the frequent rotation of military personnel creates a pool of “inexperienced” workers in many commercial activities leading to increased competition savings.

omnibus contracts, it is still more commonplace for activities to compete small, individual functions at specific locations.

(Table 1) **Savings as a Function of Contract Size**

<u>Number of Billets</u>	<u>Completed Competitions</u>	<u>Percent Savings</u>
1 to 10	857	22%
11 to 30	728	28%
31 to 50	212	31%
51 to 75	115	27%
76 to 100	67	32%
101 to 200	88	29%
Over 201	71	35%
<u>Total</u>	<u>2,138</u>	<u>Ave. 31%</u>

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*1978-1994 DoD Commercial Activities Competition Data*

The rate of savings increases with contract size for several reasons. When billets are competed individually, the resultant savings are primarily derived from salary and compensation differences between the in-house and outside providers. In contrast, larger contracts provide better opportunities to leverage economies and efficiencies of scale, and provide greater flexibility in how people are used. A more efficient outside provider is more likely to perform larger tasks with fewer people, thus increasing the rate of savings. Larger, bundled contracts with a greater scope of functional activities also tend to attract

more bidders. This increases the magnitude of competitive forces which, as stated earlier, are the primary drivers of cost and efficiency savings.

Smaller contracts increase the cumulative impact of some short-term costs. These costs are not factored into the Table 1 data, but are felt by the affected activities. For example, the administrative "overhead" (the ratio of administrative requirements to the number of billets competed) is inversely proportional to the number of billets contained in the contract. In light of this administrative drawback for smaller contracts, it is surprising that the category with the most full competitions completed is for *1 to 10 billets*. Even more striking is the fact that full competitions are not required for these small functions. According to CNA, full competitions may still have been completed because of "...old regulations, statutory limitations placed in the appropriation bills, perceived regulations, DoD policy, a predisposition by managers to fragment functions (with the intent of increasing in-house competitiveness), or because the standardized process of a full competition is easier to defend."<sup>43</sup>

***Competing different functional areas produces different levels of savings.*** Savings can also be viewed as a function of the type of activity being competed. Both public and private sector competition data show that certain functions produce greater savings than others. By considering the savings per billet and the number of competition-available billets for different functional areas, a prioritized list of functions can be generated based on their estimated levels of savings.

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<sup>43</sup> Center for Naval Analyses, Implementing A-76 Competitions CAB 96-24 (Alexandria, VA: 1996), 6.

The Navy has generated a list of their “Top 20” functions with the greatest estimated savings by using this straight-forward methodology. The Navy’s “Top 20” functions would yield an estimated \$2.1 billion in savings if they were competed in total. The top six of these 20 functions account for 55 percent of the total \$2.1 billion estimated savings. These functions with corresponding savings estimates (in \$millions) follow: *vessels D-level maintenance* \$291; *specialized skill training* \$241; *guard service* \$196; *vessels I-level maintenance* \$188; *nursing services* \$116; and *aircraft I-level maintenance* \$188.<sup>44</sup>

If competitive sourcing was purely a cost-saving exercise, this methodology would be extremely useful in developing strategies that prioritize functions for competition. However, the political and administrative costs are not fixed across functional areas. Therefore this methodology can be employed as a useful tool to identify where higher savings can be found, but it does not adequately measure other important costs that are more difficult to quantify.

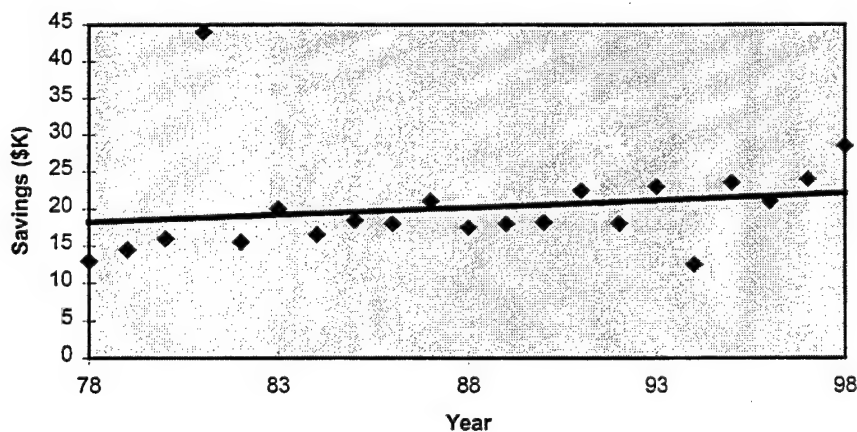
*Average savings are increasing over time.* Recent studies of past competitions show that savings per competed billet are steadily increasing over time (refer to Figure 3). An unlimited number of theories could be presented to account for this growth; however, only a few seem worthy of mention. 1) This data could indicate that DoD activities have not used savings as the primary criteria for selecting functions for competition. In other words, there was no “cherry-picking” effect that resulted in all the high-savings functions

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<sup>44</sup> Center for Naval Analyses, Outsourcing and Competition: Lessons Learned From DoD CA Programs (Alexandria, VA: 1996), 6.

being competed first. This theory suggests that there are still high payoff opportunities remaining to achieve increased cost savings. 2) Another argument would be that more senior, higher paying billets are being protected. As the years passed, and activities were forced to compete more functions, they may have cut more deeply into more senior billets. Both theories are not contradictory, and in fact can explain the trend from two different, complimentary perspectives. It is important to at least recognize that the dynamics causing this growth are probably very complex, and best ascribed to multiple, interacting variables.

(Figure 3) Savings per Competed Billet



source: Dr. Sam. Kleinman, Director, CNA Infrastructure and Readiness Team

***Civilian separation options have different short-term costs for the losing activity.***

Base commanders must deal with the short-term costs associated with outsourcing functions. One significant component of these short-term costs involves buyouts and the relocation of civilian personnel. Civilian employees losing positions as a result of

outsourcing have several options depending on the specific circumstances involved.

Many of these options generate short-term costs within the losing activity.

Data gathered during a recent study of departing civilians at Naval Air Station (NAS) Alameda and the Naval Supply Center (NSC) Oakland identified eight departure options available to displaced civilians:<sup>45</sup>

- 1) Personnel Priority Placement Program (PPP).
- 2) Variable Separation Incentive Pay (VSIP).
- 3) Regular retirement/Retirement with VSIP.
- 4) VSIP with optional Variable Early Retirement Annuity (VERA).
- 5) Reduction in Force (RIF).
- 6) Transfer to another federal activity.
- 7) Termination/Medical Termination.
- 8) Voluntary resignation/separation.

These options have different associated short-term costs making some more economically desirable than others. For example, NAS Alameda obligates approximately \$38,500 per PPP employee.<sup>46</sup> The VSIP program, often referred to as a program of "buyouts", has certain features according to the Fiscal Year 1997 Omnibus Spending Law.<sup>47</sup> Under this law, the amount of the buyout is equal to the lesser of: 1) A severance pay calculation; 2) \$25,000; or 3) An amount determined by the agency head. At the

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<sup>45</sup> Naval Post Graduate School, Outsourcing: Short Term Costs and Human Resources Issues (Monterey, CA: 1997), 21.

<sup>46</sup> Ibid.

<sup>47</sup> Public Law 104-208, dated 30 September 1996.



other end of the spectrum, voluntary resignations and separations have no direct associated costs for the losing activity.

## UNCONSTRAINED COMPETITIVE SOURCING

*The maximum extent of competitive sourcing* If history suggests that sustained savings are possible through competitive sourcing, then what is the *maximum* amount achievable? This section will consider an extreme scenario whereby the *complete* DoD CA inventory would be subjected to competition. This analysis will yield an upper limit for potential savings offered by competitive sourcing.

OMB Circular A-76 establishes federal policy regarding the performance of commercial activities (*refer to Appendix A for U.S. Government policy regarding commercial activities*). The A-76 program was formalized in 1955 when the Eisenhower Administration issued Bureau of the Budget Bulletin 55-4 which stated: "It is the general policy of the Federal Government that it will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels." In 1966, the Bureau of the Budget issued the policy as Circular A-76.<sup>48</sup> Guidelines for competition were subsequently updated in 1979, and again in 1983. The supplement to the Circular sets forth procedures for determining whether commercial activities should be performed under contract with commercial sources or in-house using government facilities and personnel.<sup>49</sup> OMB A-76 defines a commercial activity as one that is operated by a federal

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<sup>48</sup> Office of Management and Budget, Enhancing Governmental Productivity Through Competition (Washington: 1988), 1.

<sup>49</sup> Office of Management and Budget (OMB) Circular No. A-76, August 1983.  
<<http://www.whitehouse.gov/WH/EOP/html/circulars/a076/a076.html>>

executive agency and which provides a product or service which could be obtained from a commercial source (*refer to Appendix B for a listing of commercial activities*).

*Inherently governmental* functions are defined in OMB A-76 as functions that are “so intimately related to the public interest as to mandate performance by government employees. These functions include those activities which require either the exercise of discretion in applying government authority or the use of value judgment in making decisions for the government.”

The central thrust of current policy guiding competitive sourcing has two predominant themes:

- 1) All new requirements that can be performed by private sector commercial sources must be acquired from such sources, except where a statute or national security interests require government performance or where private industry costs are unreasonable.
- 2) Commercial activities currently being performed by the government shall be compared to private sector sources to determine which can provide the work in the most cost effective manner.<sup>50</sup>

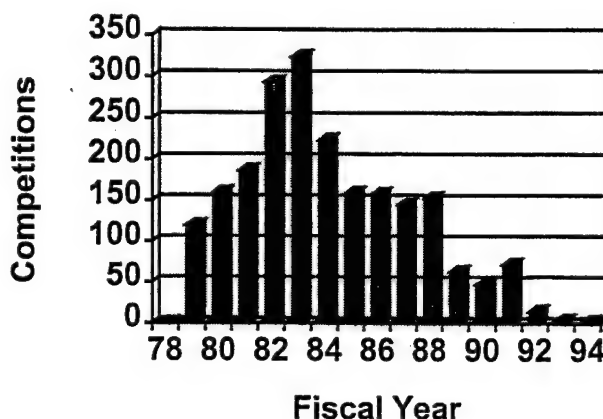
DoD has been competing commercial functions under the CA Program since 1978. This program grew considerably, and by 1994, DoD had completed 2,138

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<sup>50</sup> Office of Management and Budget, Enhancing Governmental Productivity Through Competition (Washington: 1988), 1.

competitions.<sup>51</sup> These competitions affected 81,990 defense employees as summarized in Figure 4.

(Figure 4) **Completed Competitions**



Following this string of DoD competitions, the FY 1994 CA inventory database consisted of 639,846 FTEs.<sup>52</sup> Stated another way, 639,846 FTEs were considered to be potential candidates for competition. Almost 53 percent of the total inventory was civilian, while the remaining 47 percent served in uniform.<sup>53</sup>

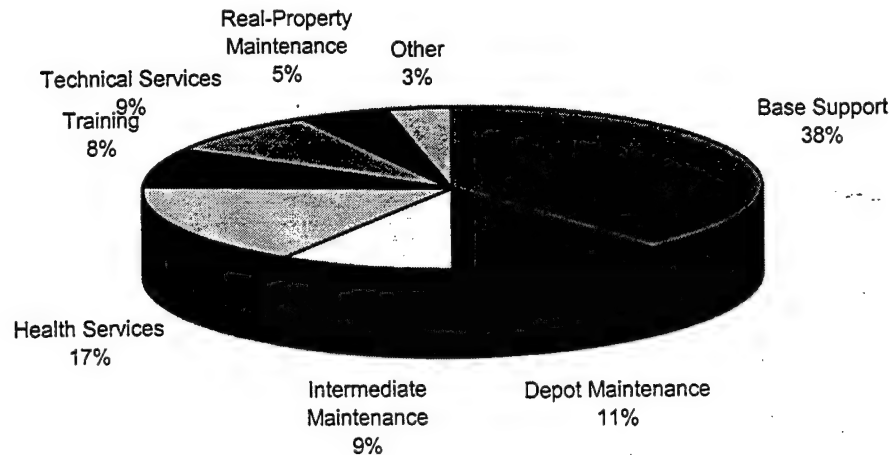
Interestingly, only one year later, having competed almost none of those FTEs, DoD reduced its CA inventory (on paper) by almost 50 percent—to 389,100 FTEs. Of this new total, 64 percent were civilian and 36 percent were military. The 1995 DoD CA inventory is shown by functional area in Figure 5.

<sup>51</sup> Center for Naval Analyses, Outsourcing and Competition: Lessons Learned From DoD CA Programs (Alexandria, VA: 1996), 5.

<sup>52</sup> This number does not include billets that were already outsourced between 1978 and 1994.

<sup>53</sup> FY 1994 CA Inventory Data.

(Figure 5)  
**FY 1995 Commercial Activities Inventory by Functional Area**



*Source: 1995 DoD Commercial Activities Inventory Data*

The point to be made here is not that DoD miraculously reduced over half of the CA inventory in one year, but rather to illustrate just how skeptical one should be when assessing estimates of the CA inventory. All subordinate agencies and departments in DoD have experienced considerable difficulty in categorizing commercial activities as prescribed by OMB A-76. The reasons include: subjective interpretation of A-76 guidelines; organizational inclination towards self-preservation; inability to accurately categorize large, functionally-diverse, and geographically-dispersed work forces in dynamic environments; and organizational adjustment to work force reductions driven by previously completed outsourcing and the defense "draw-down".

The QDR forced policy makers to grapple with these fuzzy CA inventory numbers to better estimate the potential savings offered by competitive sourcing programs. In an effort to reduce this uncertainty, the Secretary of Defense issued Defense Reform Initiative Directive Number 20 (DRID#20).<sup>54</sup> DRID#20, "Review of Inherently Governmental Functions", directed DoD components to code functions and positions within the CA inventory that are inherently governmental, commercial activities (exempt from competition), and commercial activities (subject to competition) by 31 Oct 98. The results of the coding were reviewed by OSD to ensure uniform application of OMB A-76 guidelines. The results were later briefed to the Defense Management Council to be compiled into the DoD FY 1998 CA inventory for submission to Congress in January of 1999.<sup>55</sup>

A compilation of the initial DRID#20 feedback from DoD components now puts the CA inventory at about 902,000 FTEs.<sup>56</sup> This estimate of the CA inventory is more than double the estimate of the 1995 CA inventory which included 389,100 FTEs, and even considerably exceeds the 1994 CA inventory estimate of 639,846 FTEs.

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<sup>54</sup> After the DRI report was released in 1997, Defense Reform Initiative Directives (DRIDs) were released covering over 40 issues that required reports to the Deputy Secretary of Defense on review or implementation of most of the initiatives identified in the report.

<sup>55</sup> Interview with a representative from the Deputy Under Secretary of Defense (IA&I) Competitive Sourcing and Privatization Office, December 1998.

<sup>56</sup> Identity of the source is withheld.

## *Estimation of Cost Savings*

Table 2 summarizes the savings from 2,138 competitions conducted from 1978 to 1994 that examined a total of 81,990 FTEs.<sup>57</sup>

(Table 2)

### **Competition Yields Significant Savings**

	Competitions <u>Completed</u>	Average Annual <u>Savings(\$M)</u>	Percent <u>Savings</u>
Army	510	\$470	27%
Air Force	733	\$560	36%
Marine Corps	39	\$23	34%
Navy	806	\$411	30%
Defense Agencies	50	\$13	28%
<b>Total</b>	<b>2,138</b>	<b>\$1,478</b>	<b>31%</b>

Results of A-76 Cost Comparison: 1978-1994 (source: CNA)

The average savings per competed billet from the 1978-1994 data was about \$18,000 (in 1996 dollars); roughly \$18,720 (in 1998 dollars).<sup>58</sup> This data can be carried forward to make comparative estimates. A simplified calculation to determine the potential cost savings gained by hypothetically competing the entire FY 1998 CA inventory yields an estimated savings of **\$16.9 billion** per year once completed.<sup>59</sup>

<sup>57</sup> CNA's computation methodology for total annual savings considers: the baseline number of civilians and military personnel performing the function prior to the competition; the "in-house" bid (including the cost and number of personnel for the "most efficient organization" (MEO)); the lowest contractor bid; and the results of the competition (who won). Baseline cost estimates assume that the change in the "in-house" costs is proportional to the change in personnel. For example, if the MEO uses 20% fewer personnel than the baseline, then baseline costs are estimated to be 20% greater than the "in-house" bid. Given both baseline costs and the winning bid, savings can be easily calculated.

<sup>58</sup> Estimate is based on a 2% annual rate of inflation.

<sup>59</sup> Annual cost savings = [total billets competed X savings per billet] = [902,000 X \$18,720] = \$16,885,440,000.

Competitive sourcing requires time, and thus the realization of cost savings is not instantaneous. This creates a "ramp effect" for annual savings growth as competitions are completed over time.

Obviously, savings of this magnitude would exceed even the optimistic estimate of the DSB by a considerable margin. Unfortunately, some portion of the 902,000 (CA inventory) FTEs cannot be competed for several reasons. The next section considers these reasons in more detail, and attempts to establish an estimate of what portion of the CA inventory can be competed.



## LIMITATIONS AND IMPEDIMENTS PREVENTING "MAXIMUM" COMPETITIVE SOURCING

An examination of the impediments preventing the competitive sourcing of DoD's complete CA inventory follows.

### *Legislative Impediments to Competitive Sourcing*

The current legal and regulatory environment delays, complicates, and discourages competitive sourcing. The statutes listed below, increase Congressional involvement in the competitive sourcing process, thus increasing the opportunity for the politicization and micromanagement of the entire A-76 program. Many of the statutes require Congressional notification, reporting, and other burdensome procedures that only stagnate an already inefficient procedural system.

- 1) DoD is prohibited from contracting out more than 50% of depot maintenance functions. Depot maintenance activities include over 90,000 FTEs from the CA inventory.<sup>60</sup>
- 2) DoD is prohibited from contracting out core logistics functions (10 USC 2464). OMB estimates that this restriction alone affects 75,000 FTEs with potential savings of \$1.5 billion.

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<sup>60</sup> This estimate is conservatively based on the FY 1995 CA inventory functional area composition. CNA reported that 11% of the 1995 CA inventory was performing depot-level maintenance functions. 10% of the current CA inventory equals 90,200 FTEs.

- 3) DoD is prohibited from contracting out fire-fighting and security activities at most military bases (10 USC 2465).
- 4) Depot maintenance work greater than \$3 million may not be outsourced without public/private cost comparisons (10 USC 2469).
- 5) Both a "Most Efficient Organization" MEO analysis and a cost effective analysis are required to be completed, and the results certified to the Congressional Committees on Appropriations for all functions of more than 10 DoD civilian employees before outsourcing can be conducted (Sec 8020, FY 96 Appropriations Act).
- 6) No funding will be provided for A-76 studies which exceed 24 months (for one function), or 48 months (for more than one function) (Sec 8043, FY 96 Appropriations Act).
- 7) Base commanders were given sole authority to commission A-76 cost comparison studies at their installations. Although this statute expired on 30 Sep 95, it contributed significantly to the dramatic decline in the number of A-76 studies completed during the first half of this decade (10 USC 2468).
- 8) Army Depots are required to maintain civilian personnel levels for communications-electronic depot maintenance above the levels on 30 Sep 85.<sup>61</sup>

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<sup>61</sup> Naval Post Graduate School, Outsourcing: Short Term Costs and Human Resources Issues (Monterey, CA: 1997), 17.

- 9) Contracting out is forbidden for all functions at the Crane Army Ammunition Activity and the McAlester Army Ammunition Activity (Sec 317, FY 87 Authorization Act).
- 10) The Army Corps of Engineers is prohibited from conducting A-76 studies at any reservoir in Mississippi.<sup>62</sup>

### ***OMB Circular A-76 process inefficiencies***

Rules imposed by OMB Circular A-76 make competitive sourcing a strenuous task for DoD component organizations. "Virtually every rule and regulation, since the original OMB A-76 circular, has been designed to hinder—not promote—outsourcing."<sup>63</sup> While OMB A-76 states that it is official government policy to rely on the private sector for commercial-type products and services, it introduces a highly formalized set of legalistic rules and procedures that demand the expenditure of an inordinate amount of time and resources. The revised edition of OMB A-76 (Transmittal Memorandum No. 15) dated 27 Mar 96, contains 78 pages of requirements and instructions for completing the MEO and the Performance Work Statement (PWS)--(two-page forms). The net effect of the A-76 package is to hinder competition, and to favor the in-house team when cost comparisons are made.

The first requirement of the A-76 process is the development of a PWS that describes the function to be studied for competition. After the PWS is completed, DoD

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<sup>62</sup> Ibid.

<sup>63</sup> Center for Naval Analyses, Outsourcing and Competition: Lessons Learned From DoD CA Programs (Alexandria, VA: 1996), 24.

solicits bids and proposals from the private sector. Concurrently, the DoD organization that is performing the function submits the MEO cost proposal. This proposal is not based on the prevailing cost structure for the specific function, rather it is based on that of the "most efficient organization". This MEO often recommends personnel cuts and other cost-saving measures to reduce total activity costs. DoD next compares the contractor's proposal with the MEO projection. The private contractor can win the contract only if his bid is more than 10 percent less than the MEO's projected cost. This process takes an average completion time of about 24 months, and over 40 percent of cost studies take longer than 24 months to complete.<sup>64</sup>

In-house activities have a considerable advantage under current A-76 rules. Not only does the private sector team have to beat a "notional" adversary (the MEO), but it has to beat the MEO by more than 10 percent. This can cause the private sector team to "buy in"—submitting a bid lower than the actual cost of performing the function in order to win the contract. This often times results in the private sector team incurring substantial losses as a direct result of the A-76 process. Government teams are generally accustomed to operating in competition-free environments, and as a result are rarely worried about continuously striving to gain process efficiencies. It seems inappropriate that they should be given the opportunity to become efficient on paper, through the MEO, and then be able to compete using the MEO with a built-in 10 percent total cost advantage.

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<sup>64</sup> GAO Report to Congressional Committee, "Federal Productivity: DoD's Experience in Contracting Out Commercially Available Activities," November 1988.

DoD organizations lack effective cost accounting systems and internal controls to ensure accurate allocation of indirect costs. Many A-76 competitions are decided on the basis of government proposals that do not include all relevant costs. The government's cost accounting system has been designed to facilitate "control and reporting to Congress—not managing enterprises."<sup>65</sup> The private sector bid includes indirect costs, while the "in-house" cost estimate does not. The U.S. Chamber of Commerce estimated that this represents a 20 to 30 percent handicap for the private sector team. Most government activities couldn't begin to quantify indirect costs because there are so many different "pots of money" within any given installation. Most overhead costs that the private sector must account for, are transparent to managers at the lower levels where competitive sourcing takes place.

There are morale costs associated with the A-76 competition process. The fact that most studies span several years takes a toll on the morale and productivity of the federal employees whose jobs are at stake—the same people who are burdened with performing the cost studies.

A-76 is focused very narrowly, as roughly 75 percent of all completed studies from 1978 through 1994 were for contracts consisting of only 1 to 30 billets. This increases the administrative overhead per billet competed, thus diminishing potential cost savings.

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<sup>65</sup> Department of Defense, Report of the Defense Science Board Task Force on Privatization and Outsourcing (Washington: 1996), 45A.

***Impact on combat effectiveness and efficiency (by competing selected sustainment functions)***

Sustainment functions such as transportation, supply, general engineering, maintenance, and miscellaneous services are readily available, responsive, and economically provided in the private sector. Since most of these functions are not currently categorized by the services as commercial activities, they offer an untapped source of potential outsourcing candidates.

Outsourcing selected combat sustainment functions is an inherently risky proposal. As contractors are placed in a high threat environment, they rely on the supported force for their physical security needs. This potentially leads to degraded combat mobility and flexibility by increasing the supported unit's logistical burden. According to a recent report from the Army War College, there are four primary limitations affecting the introduction of contracted employees to the battlefield:<sup>66</sup>

- 1) ***chain of command compliance*** Commanders have no direct command and control over contractors. The introduction of private contractors into combat situations would create a situation in which organizational authority would flow through two separate organizational structures. The contractor's chain of command flows from the Contracting Officer Representative (COR). Local military commanders do not have authority to order contractors to perform any action that is not covered within the scope of the contract. "Overall, this

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<sup>66</sup> Army War College, Potential Combat Risks from Outsourcing Selected Sustainment Functions (Carlisle Barracks, PA: 1998), 60-63.

problem can be characterized as a lack of clear understanding of roles and responsibilities by each partner—military and contractor, which results in a lack of clear command and control.”<sup>67</sup>

- 2) **legal status** Even though contractors are not combatants according to U.S. policy, “their legal status in theater can be very confusing since there is a fundamental question of whether they are members of the force or not.”<sup>68</sup> A 1997 study conducted by the Army Materiel Command determined that where “...civilians augment the Army in areas where technical expertise is not available or is in short supply, they in effect become substitutes for military personnel who would be combatants.”<sup>69</sup> Civilians accompanying the armed forces in combat are entitled to protection under both the Geneva and Hague Conventions. However, the actual status of a civilian in a prisoner of war situation would be extremely difficult to discern, and would largely be determined as a result of the type of service being provided.
- 3) **readiness factors** As a general rule, service providers from the private sector do not demand the same high degree of preparedness from their employees in the areas of medical, dental, legal, and financial readiness. Other related issues of readiness that the services pay keen attention to include weapons qualification, physical fitness testing, Nuclear Biological and Chemical (NBC)

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<sup>67</sup> Ibid.

<sup>68</sup> Ibid., 61.

<sup>69</sup> Larry L. Toler, “Civilians on the Battlefield,” Memorandum for Deputy Chief of Staff for Logistics, 1997.

defense training, and equipment serviceability. These areas all have a direct impact on the services' ability to accomplish their mission in times of war.

- 4) ***support factors*** Contractors must plan to provide all the requisite support for their personnel prior to any deployment. Specific needs such as suitable clothing, protective gear, weapons, and family support services would need to be considered. These considerations would introduce additional cost and detail for any contractor's bid.

### ***Military strain***

Another important parameter the services must consider when competing military billets is the resulting increase in operational tempo (OPTEMPO). With an ever-increasing number of worldwide deployments, the services are under a higher degree of strain, and have seen many quality of life issues deteriorate. Secretary of Defense Cohen has made improving the quality of life for service members and their families a top priority within the framework of the recent QDR.

Outsourcing support jobs in the Continental United States (CONUS) has a direct impact on the rotation of deployed or at-sea personnel. The services rotate their personnel between varied assignments that require differing degrees of hardship. In many cases, CONUS support assignments allow service members an opportunity to enjoy more family time with fewer deployments and reduced readiness requirements. The elimination of these billets would increase the likelihood of overseas assignments, and decrease opportunities for service members to catch their breath. This would effectively



increase the hectic pace of military life for soldiers and sailors that already spend a significant portion of their careers away from their homes and families.

### ***Military personnel management concerns***

Competing military functions has significant ramifications for the services. Outsourcing military billets threatens the following areas that are critically important facets of the personnel management system:

***career progression*** Service members are trained from their initial entry to active duty along a well-defined path that offers promotion and professional growth over a full career of service. Along many individual career paths, lie both governmental and commercial functions. By outsourcing certain commercial functions, the military runs the risk of depriving service members the opportunity to learn skills that may be later required in certain inherently governmental positions. These skills often contribute materially to the overall readiness of units. Needless to say, restructuring the "career pipeline" system would be a monumental task for all of the services, and would certainly be grounds for institutional resistance.

***recruiting and retention*** Currently, all the services are facing very serious challenges in meeting both recruitment and retention goals.<sup>70</sup> Outsourcing, on the surface, appears to make limited sense while the services are unable to retain the people they need to accomplish their respective missions. Retention problems could be further exacerbated by negative perceptions commonly reported by units facing competition

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<sup>70</sup> This point was clearly made by three individual service chiefs during lectures at the Naval War College during the 1998-1999 academic year.

studies. However, outsourcing might reduce recruitment quotas by removing military billets from the force structure. What isn't clear is the impact outsourcing would have on DoD's ability to present an attractive career package to potential recruits.

***Organizational/institutional/cultural resistance to change*** A significant drawback or impediment to outsourcing is the desire to preserve DoD's culture. DoD is rightfully focused on fighting and winning America's wars. Our proud military history tends to reinforce a strong preference for keeping support organizations in-house. Our military culture has long been recognized as a bastion of conservatism and risk-aversion. Until personnel evaluations are realigned to reinforce effective competitive sourcing, and incentives are established to tangibly reward those who meet DoD's objectives, base commanders will continue to protect the job security of their staffs. With cumbersome and confusing A-76 guidelines, slanted interpretations will continue to work against competitive sourcing initiatives.

***Force demographics and Equal Opportunity Employment (EEO) implications*** Wide-scale competitive sourcing will inevitably have an impact on force and work-force demographics.

***military*** For the services, competitive sourcing naturally targets support functions. A higher percentage of women serve in support-related functional areas that can be classified as commercial activities. This fact is most pronounced in the Army and the Marines where the ground combat troops are practically all male. This would have

the undesirable effect of reducing the percentage of female service members as a fraction of the total force. However, no mention of this consideration has been made in any previous study that the author is aware of.

**civil service** Outsourcing generates a ripple effect throughout target activities and organizations due to the seniority structure within the civil service system. Civilian candidates for reduction-in-force (RIF) are eligible to take the position of junior employees with similar skills. This phenomenon is commonly referred to as “bumping and retreating” within a command. Periods of bumping and retreating result in dynamic transition for the affected activity causing decreased productivity over the short-term. Long-term results include accelerated aging of the civilian workforce as senior workers bump junior workers. Defense organizations tend to drive away the people they can least afford to lose—younger people with new skills and high energy.

**EEO implications** In 1994, the GAO reported the Equal Employment Opportunity implications of force reductions at three DoD installations.<sup>71</sup> Minorities were separated in numbers disproportionate to the numbers in the total work force at all three locations. Women were separated disproportionately at two of the three locations. GAO stated that this was a result of the fact that minorities and women did not have adequate tenure, veteran’s preference, or performance-adjusted seniority as did non-minorities or men. In some cases, the disproportionate separations were attributed to the fact that minorities occupied a larger portion of the positions eliminated. A 1991 GAO report found that minorities and women ranked lower than their non-minority and male

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<sup>71</sup> Force reductions in these cases were primarily the result of RIFs, and secondarily, of outsourcing. The implications of these results are assumed to be applicable to outsourcing.

counterparts in all retention factors. These results indicate that the diversity of the workplace stands to be threatened by heavy outsourcing initiatives.

### ***Difficulties in accurately calculating the CA inventory***

Several factors make it very difficult for DoD to gain good visibility of, and access to all the billets within the CA inventory. These frictional factors remain relatively constant and tend to erode the actual number of billets that can be competed. The following circumstances have the net effect of reducing billets programmed for competitions by 5 to 10 percent.<sup>72</sup>

***Small Numbers Problem*** It is very difficult to produce contracts for individual billets that are geographically dispersed. Activities often opt to avoid contracts for one or two billets viewing the benefits as not being worth the time and effort.

***Non-Separable Positions*** Certain commercially appropriate functions are tied directly to, and are not separable from certain inherently governmental activities. For example, the secretary for a combat systems developer may not be separable from that activity based on the nature and requirements of that activity. Specific continuity issues, security concerns, and other mission-related requirements could categorize the billet as "non-separable".

***Fluid organizational structures*** Possibly the most significant of the three frictional factors stems from the fact that DoD seems to be in a state of constant organizational flux. DoD is still adjusting to the end of an era of draw-downs that

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<sup>72</sup> Interview with a representative from the Deputy Under Secretary of Defense (IA&I) Competitive Sourcing and Privatization Office, December 1998.

reduced DoD end strength by approximately 40 percent. Quite often, billets are projected to be in future CA inventories, and are subsequently moved, re-coded, or eliminated altogether. This can make an activity's estimate of commercial functions an educated guess at best.

### ***DoD's methodology for exempting billets from competition***

DRID#20 attempted to measure many of these impediments to competitive sourcing by requiring each component service and defense agency to distinguish inherently governmental jobs from those deemed commercial activities, and to further subdivide those jobs deemed commercial activities between those subject to competition and those exempt from competition. OSD developed a "Manpower Mix Criteria" worksheet based on the A-76 guidelines to assist defense organizations in coding their billets as required by DRID#20. The three larger categories are shown below with their respective sub-codes:

#### ***Inherently Governmental***

Military Combat (A)

Military Unique Knowledge and Skills (C)

Civilian Authority and Direction (G)

Civilian Expertise and Control (H)

### ***Exempt From Competition***

Military Combat Augmentation (B)

Military Image and Esprit de Corps (D)

Military Rotation (E)

Military Career Progression (F)

Civilian National Security and Operational Risk (I)

EO, Law, Treaty, or International Agreement (J)

Legislatively Mandated Floors (K)

DoD Management Determination (L)

### ***Subject to Competition or Direct Conversion***

Based on Cost Comparison (M)

Pending Contract Award (N)

Pending Cost Comparisons Results (O)

Pending Restructuring Decision (P)

Based on Terminated Cost Comparison (Q)

Subject to Review (R)

***\*Reason Codes (A thru I) are categorized as "Core Manpower"***

- *Within "Core Manpower", reason codes (A thru F) are categorized as "Military Essential", and reason codes (G thru I) are categorized as "Civilian Essential".*

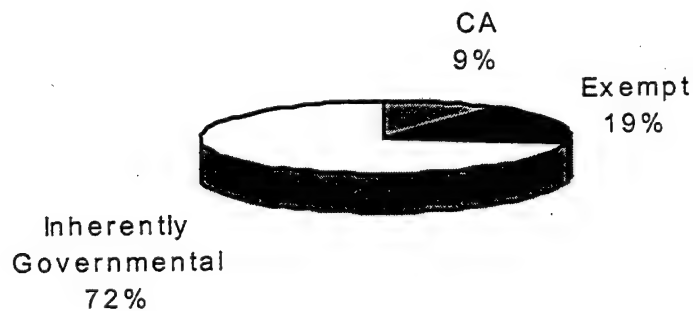
***\*Reason Codes (J thru R) are categorized as "Non-Core Manpower"***

- *Within "Non-Core Manpower", reason codes (J thru L) are categorized as "Restricted", and reason codes (M thru R) are categorized as "Not Restricted"*

Note that the exemption criteria have been designed to compensate for many factors that make full-scale competitive sourcing impractical. Figure 6 shows how DoD's total population was coded using the above-listed criteria. Figures 7 and 8 provide the breakout for both the military and civilian populations, respectively:

(Figure 6)

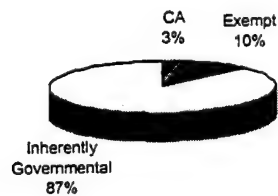
## Total DoD Population Inventory



*Initial DRID#20 Response*

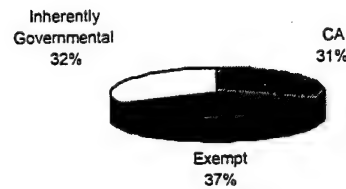
(Figure 7)

## Military Population Inventory



(Figure 8)

## Civilian Population Inventory



*Initial DRID#20 Response*

DoD's total CA inventory consists of commercial activities that are either *subject to competition* or *exempt from competition* (as represented by the two darker wedges in Figure 6 above). The initial response to DRID#20 identified 28 percent of the entire DoD population (902,000 FTEs) as commercial activities. 283,000 FTEs<sup>73</sup> were classified as being subject to competition or direct conversion, while 619,000 FTEs were deemed to be exempt from competition. The exemption criteria spelled out in OMB A-76 and the Manpower Mix Criteria allow for liberal application as demonstrated by the initial DRID#20 results. If we reduce the 902,000 (CA inventory) FTEs by those declared exempt from competition, the maximum savings from competitive sourcing drops from \$16.9 billion to \$5.3 billion.

Although the reduction is dramatic, this \$5.3 billion estimate still more than doubles the \$2.5 billion that OSD had hoped for as competitive sourcing's portion of the overall DRI savings goal. In fact, the \$5.3 billion alone, would satisfy most of the \$6.5 billion annual DRI savings target. Even if DoD only completes 80 percent of all programmed competitions, over \$4 billion will be saved annually.<sup>74</sup> These calculations demonstrate the potentially powerful impact of competitive sourcing as a means of producing significant internal savings. If we consider \$4 billion to be a conservative estimate, the question now becomes: *Is there a reason to believe that DoD can do better?*

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<sup>73</sup> These 283,000 are not above and beyond the 237,196 billets already programmed over the FYDP. The 283,000 represent another, more recent estimate of current competent billets from the CA Inventory.

<sup>74</sup> DoD's current (and historic) completion rate for programmed competition exceeds 80 percent.



## RECOMMENDATIONS

Recommendations for obtaining increased savings (beyond \$4 billion) are developed and explored in this section. These recommendations attempt to integrate the lessons learned from previous DoD competitions with practical considerations that address the challenges presented by the numerous and complex impediments to competitive sourcing.

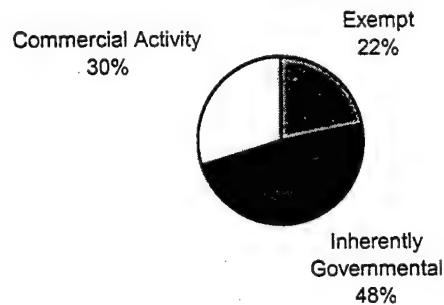
*Primary recommendations are as follows:*

- 1) **Aggressively review the defense agencies' inventories.**
- 2) **Consider outsourcing more military billets in the FYDP outyears.**
- 3) **Level the effort across DoD.**
- 4) **Increase the size and scope of contracts.**
- 5) **Align organizational goals, incentives, and performance metrics.**
- 6) **Improve A-76 administration.**
- 7) **Establish outsourcing offices and staffs.**
- 8) **Introduce a legislative package that removes statutory barriers to competition.**

**Defense agencies** The Defense Logistics Agency (DLA), the Defense Commissary Agency (DeCA), the Defense Information Systems Agency (DISA), the Defense Finance and Accounting Service (DFAS), and 25 other defense agencies have a combined

population of 135,881.<sup>75</sup> These agencies make extremely strong candidates for outsourcing because of the clear commercial flavor of the functions they perform. In responding to the DRID#20 reporting requirement, the agencies claimed that only 30 percent of their total population should be subject to competition based on their interpretation of the A-76 guidelines. This is because these agencies have reported themselves to be 48 percent inherently governmental—more than 15 percent higher than the DoD average for civilians. Based on the commercial nature of the activities performed by the defense agencies, it appears that the percentage declared to be inherently governmental should be reviewed.

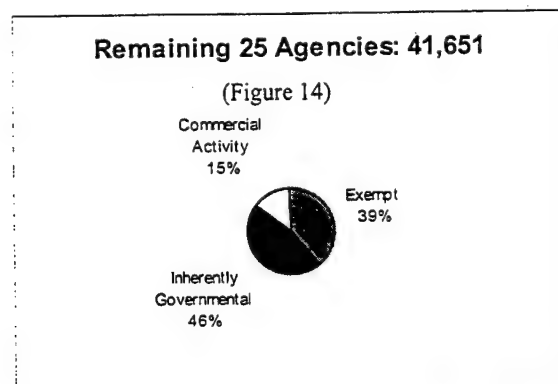
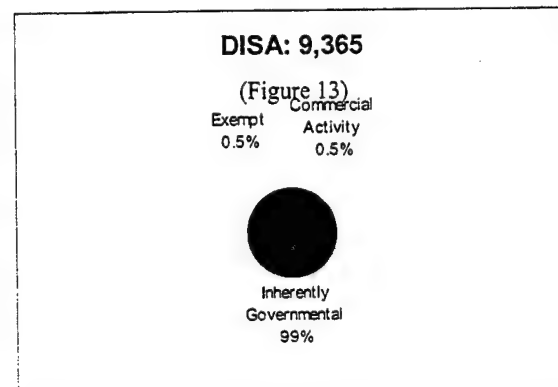
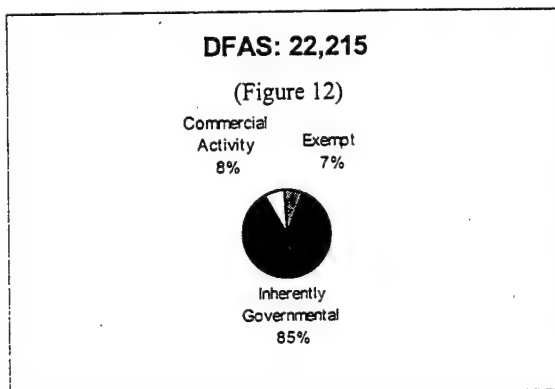
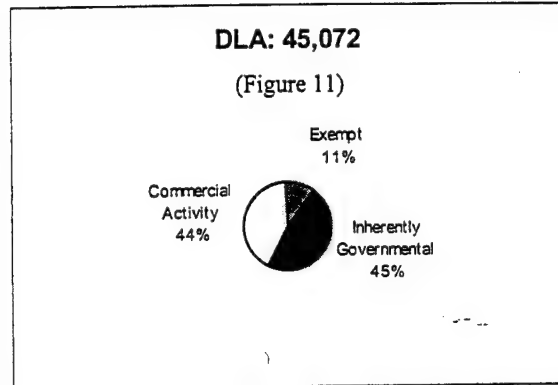
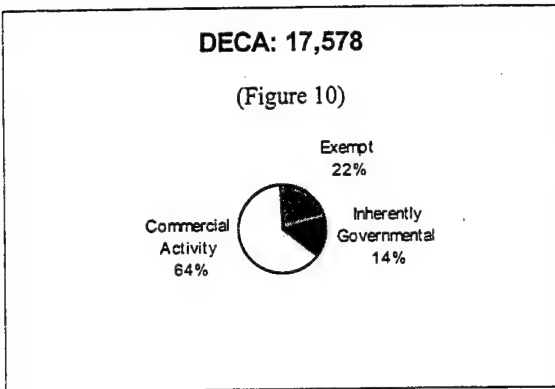
(Figure 9)  
All Defense Agencies: 135,881



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<sup>75</sup> Identity of source is withheld.

A comparison across agencies reveals more:



DLA reported that 44 percent of its workforce is subject to competition. This could be accounted for by considering the impact of restrictive legislation that leaves room for subjective interpretation. 10 USC 2464 requires that DoD maintain “core” logistics capabilities to support mission-essential systems. Additionally, the revised

version of 10 USC 2466 allows no more than a 50/50 split between in-house and contracted depot-level maintenance. Both of these statutory requirements provide DLA with ample maneuver space to avoid heavy competitions. A refined interpretation of "core" logistics capabilities is required. It is also imperative that arbitrary limits to outsourcing be replaced with policy that incorporates service quality, reliability, and economy as fundamental sourcing criteria.

DeCA operates more than 300 commissaries at installations worldwide. Annual sales in excess of \$5 billion make DeCA the ninth largest grocery chain in the United States.<sup>76</sup> DoD subsidizes DeCA customers through various mechanisms to reduce the prices of items purchased. This allows DeCA to offer prices that are below prevailing market levels. DeCA has reported to OSD that 36 percent of their billets are either inherently governmental or exempt from competition.

DISA claims that 99 percent of their work force is inherently governmental. DISA performs centralized data processing functions for DoD. Information Technology (IT) functions in the private sector are routinely outsourced with great results. Due to the exponential advancement of data processing, storage, and retrieval capabilities, private sector enterprises continue to rely more heavily on specialized IT service providers. A 1995 study of DISA's operations concluded that DoD could achieve \$1.25 billion in savings from 1996-2006 through outsourcing and further consolidation with no negative impact on service delivery.<sup>77</sup>

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<sup>76</sup> Department of Defense, Report of the Defense Science Board Task Force on Privatization and Outsourcing (Washington: 1996), 61A.

<sup>77</sup> Strategy Options for Defense Information Services, (Coopers & Lybrand L.L.P.: December 1995).

DFAS is responsible for accounting, payroll, travel reimbursement, invoicing, debt management, and related support functions. A recent study concluded that it costs DoD between \$7.25 and \$10.22 per person to have DFAS administer payroll accounts, while the private sector typically spends between \$1.60 and \$3.20 per employee.<sup>78</sup> DFAS claims that only 8 percent of its work force is subject to competition under the A-76 guidelines.

At the least, DeCA, DFAS, and DISA should be evaluated further as candidates for strategic outsourcing. Legislative relief in the Congress should be explored to permit greater competitive sourcing by DLA. Even further, DoD would be well-advised to consider outsourcing the entire functional responsibility of one or more of these agencies. For DeCA, it seems reasonable to believe that several leading national grocery or retail chain stores would aggressively bid for such a large contract. DoD could leverage the magnitude and value of this type of contract to guarantee prices below market value with little or no subsidy. DFAS and DISA are ideal candidates for strategic outsourcing, and could even be functionally combined under one large contract. There are numerous private-sector companies that offer high levels of performance in these specialty areas at attractive prices for DoD.

***Consider outsourcing more military billets in the FYDP outyears.*** The DoD military service components are currently programmed to compete 211,600 billets under a plan

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<sup>78</sup> Department of Defense, Report of the Defense Science Board Task Force on Privatization and Outsourcing (Washington: 1996), 1A.

that spans from FY 1997 to FY 2005.<sup>79</sup> The services are currently executing this plan at over an 80 percent completion rate, and will have completed over half of these competitions by the second quarter of FY 2000.<sup>80</sup> The service components have felt the pinch of outsourcing during a period when recruiting and retention programs have been in serious trouble. The services are finding it difficult to compete with a robust private sector economy that is attracting more and more young men and women. There is also a growing feeling within the service components that they have offered their fair share, and will wait until the defense agencies make similar outsourcing "sacrifices". To the credit of the services, they have made proper, albeit extremely difficult, decisions in spite of the fact that the executive-level leadership is not yet completely convinced that the anticipated cost savings will materialize. The Army's Chief of Staff, General Reimer, believes that it is time to slow down and examine and confirm the savings before further competitions are planned.<sup>81</sup>

Despite expected resistance, the military still has room to increase competitive sourcing. Further competitions could be planned to further reduce the services' CA inventories, and the services could outsource specific sustainment functions that go beyond the current CA inventory.

There are several military-intensive commercial functions that still provide significant competitive sourcing opportunities. Base support and health services are

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<sup>79</sup> These 211,600 billets represent just over 89 percent of the 237,196 originally programmed to be competed between FY 1997 and FY 2005.

<sup>80</sup> Based on data provided by the DUSD(IA&I) Competitive Sourcing and Privatization Office.

<sup>81</sup> General Reimer made this point during a question and answer session after giving a presentation at the Naval War College in January 1998.

military-intensive activities that affect over 80,000 military billets.<sup>82</sup> These functional areas have traditionally been primary targets for competition. However, the functional areas of intermediate-level maintenance and training affect 47,500 military billets.<sup>83</sup> It becomes more of an issue convincing the services to compete these functions as they begin to impact more directly on the core mission of the military—"fighting and winning our nation's wars". The Air Force, Navy, and to a lesser extent Army and Marines, have successfully shifted a significant portion of maintenance and training responsibilities to the private sector. As expected, there continues to be staunch resistance within many of the services to contract certain training functions.

A more liberal interpretation of A-76 guidelines could result in the outsourcing of selected combat support and combat service support functions. In operations short of high-intensity conflict, the levels of risk experienced by contracted personnel appear to be manageable. History is replete with examples of civilians performing admirably, and in many cases, valiantly alongside service members during combat. Recent experience in contingency operations offers more support for expected high levels of performance from civilians under austere and hostile conditions. Operation Joint Endeavor in Bosnia is a great example of how the private sector can contribute in such scenarios. Brown and Root's participation in the Logistics Civil Augmentation Program cost \$100 million compared to the \$318 million it would have cost to have the soldiers do the work in

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<sup>82</sup> This number was extrapolated from the 1995 CA Inventory Data. It is assumed that this functional area has remained roughly unchanged as a percentage of the CA inventory.

<sup>83</sup> This number was extrapolated from the 1995 CA Inventory Data. It is assumed that these functional areas have remained roughly unchanged as a percentage of the CA inventory.

Bosnia. Not only were costs dramatically reduced, but service levels were reported to be significantly improved.<sup>84</sup>

However, this recommendation would require the formulation of strategies to mitigate the risks associated with placing contracted personnel on the modern battlefield in mid- to high-intensity combat scenarios. Risk reduction strategies put forth in a recent Army War College paper on this subject include:<sup>85</sup>

- Specifically delineating the potential levels of risk within a contract*
- Providing for the extension of selected UCMJ provisions for essential civilians*
- Requiring selected contract personnel to join the Individual Ready Reserve (IRR)*

These strategies provide a means of making civilian augmentation to combat units feasible, and thereby offer room to expand the extent of competitive sourcing within DoD. This concept is probably a little ahead of its time, and will definitely not happen as long as the defense agencies continue to report numbers that are clearly out of line when compared to the component service numbers. However the concept deserves further examination for possible implementation during the FYDP outyears.

***Level the effort across DoD.*** OSD is now in a good position to carefully examine the initial response to DRID#20, and then provide explicit instructions requiring resubmission of the data. OSD appears to be hesitant about imposing bogies on the

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<sup>84</sup> J. Michael Brower, "The Value of Outsourcing," Army RD&A, January-February 1999, 49.

<sup>85</sup> Army War College, Potential Combat Risks from Outsourcing Selected Sustainment Functions (Carlisle Barracks, PA: 1998), vii.



services and defense agencies. However, the option remains available as a sure-fire mechanism to quickly bring the effort to one common level across DoD.

The Navy is leading the way for the other component services in aggressively planning competitions (on a percentage basis). The Navy has reportedly proposed to compete over 40 percent of its CA Inventory.<sup>86</sup> DeCA and DLA have contributed substantially more to the competitive sourcing initiative (on a percentage basis) than has DISA or DFAS. If OSD could positively encourage all organizations to match the leading responses from peer organizations, dramatic increases in competitive sourcing could be realized. One estimate of a "leveled effort" across the services projects an additional 20,000 to 25,000 competent military billets.<sup>87</sup>

***Increase the size and scope of contracts.*** As discussed earlier, larger contracts produce increased savings. One private sector approach that effectively bundles a broader scope of functions and increases contract size is the Integrated Facility Management (IFM) concept. Approximately 150,000 personnel currently perform commercial activities within DoD's base support structure, making this area a lucrative target for increased competitions. Many base support functions are currently contracted out by functional area, with small numbers of billets included in each contract. The proliferation of these small, narrowly-focused contracts reduces executive-level visibility of support functions, increases oversight costs, and reduces opportunities for synergy among support functions. The IFM concept offers a contract methodology that integrates a broad range of

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<sup>86</sup> Identity of source is withheld due to the sensitivity of this information.

<sup>87</sup> Identity of source is withheld due to the sensitivity of this information.

functional activities within an installation or command. This enables the supported activity to include larger numbers of billets in these contracts. Not only would cost savings increase, but the responsiveness of support would be expected to increase due to the centralized management of support functions. For example, if the same contractor provided janitorial services, refuse collection, and landscaping services, common facilities could be used to maintain and store the equipment—equipment that could be used for any of the three functions. Additionally, contracted personnel could be assigned to any of the three functions based on changing workload demands. Although simplified, this example illustrates synergies that could increase service levels.

Small, geographically-dispersed activities have increased DoD's proclivity towards competing smaller contracts. A broader perspective could lead to the exploitation of regional opportunities for bundling functions. It is not uncommon for activities within the same organization to operate in several different states, and sometimes, different regions of the country or world. This strategy may have an adverse impact on the number of private bidders capable of performing functions in some regions, but would certainly have application for many organizations.

***Align organizational goals, incentives, and performance metrics.*** DoD cannot be efficiently managed through centralized *execution* of major initiatives. However, DoD would greatly benefit from leadership that clearly establishes, articulates, and aligns organizational objectives. DoD should empower its lower level units and commanders by giving them: 1) greater control over budgeted resources; 2) better information to

ascertain the financial, manpower, and time costs of their decisions; and 3) incentives that reward actions and innovations that support the overall objectives of DoD and the Services. Unit and base budgets should include the cost of military personnel. Together, these changes will foster an atmosphere of competition and customer service among military support activities. Activities that belong in the private sector will migrate to the private sector. Activities that are best provided in-house will remain in-house. Lower-level units will have effective incentives that naturally cause them to choose the most efficient and cost-effective mix of public and private providers.<sup>88</sup>

As it currently stands, installation commanders have been given little incentive to aggressively compete commercial activities. Many commanders justifiably view A-76 competitions as time-consuming and disruptive to daily operations. What's more, these installations receive little, if any, of the savings gained; and the necessary reprogramming of funds (from manpower to operations and maintenance) rarely shows up at the base level.<sup>89</sup>

***Improve A-76 administration and streamline procedures.*** The Defense Science Board Task Force on O&P concluded that A-76 is "seriously flawed and discourages outsourcing." A-76 is burdensome, time-consuming, and steeped with reporting requirements that negatively impact productivity and morale for the activity being studied. The DSB report states that "DoD should greatly reduce its emphasis on the A-76

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<sup>88</sup> Some of the ideas in this paragraph were developed during a conversation with Dr. Sam Kleinman on 12 Dec 98.

<sup>89</sup> Center for Naval Analyses, Implementing A-76 Competitions, CAB 96-24 (Alexandria, VA: 1996), 7.

process and public/private competition as the Department's primary outsourcing tools."<sup>90</sup>

Although well-intentioned, and conceptually sound in many respects, OMB A-76 provides organizations with enough verbiage behind which they can effectively hide. The DSB Task Force recommends a business case analysis method as DoD's future vehicle for identifying outsourcing candidates.

In some cases, A-76 cost studies are the only practical method to transfer commercial activities to the private sector. Therefore, it is critically important that DoD continue its effort to further streamline and expedite the A-76 process. Furthermore, DoD should attempt to reduce its reliance on formal A-76 studies when possible. Although A-76 includes provisions to conduct simplified cost comparisons for small contracts and direct conversions for some military billets, activities continue to conduct formal, standardized cost studies. DoD officials have been reluctant to use their authority, granted under A-76 rules, to waive the requirements for formal competition procedures.

The A-76 process should be automated. Order-of-magnitude efficiencies could be gained by developing a software program that automates the entire A-76 cost study process. Relative to the heavy short-term costs incurred by activities that must meet the strenuous requirements of A-76, the costs of developing this software would be negligible. If *Quicken* can integrate the United States tax code into an easy to use, fill-in-the-blank, IRS-safe, "*TurboTax*" package, then it seems that DoD could do the same for OMB A-76 cost studies.

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<sup>90</sup> Department of Defense, Report of the Defense Science Board Task Force on Privatization and Outsourcing (Washington: 1996), 50.

OMB A-76 needs to be revised to eliminate all advantages given to the in-house team. For a function to be outsourced, the top private sector bid (plus oversight costs) must be at least 10 percent (or \$10 million) below the in-house MEO. If you accept the argument that outsourcing makes good long-term sense, and if you agree that DoD needs to shed non-core functions, then you might support the argument that the private-sector team should be given any advantage that was to be had. Cost studies need to be conducted by an impartial, third party. By implementing standard, private sector decision processes, a level playing field can be achieved. Activities-Based Costing (ABC) provides another vehicle to level the playing field. This costing method makes all relevant costs visible in the competition process to remove any advantages the in-house team might gain through hidden costs.

***Establish outsourcing offices and staffs.*** A-76 competitions will be more successful if installations establish outsourcing offices. These offices would be staffed with well-trained teams to prepare both the PWS and the MEO. The outsourcing office would serve as an independent, objective third party assistance team during the competition process. The staff could proactively address transition concerns for displaced personnel. Job fairs could be organized that would encourage active participation in seeking alternate employment. The goal would be to increase the number of voluntary separations to reduce the costs incurred by other more commonly used RIF options. Another potentially powerful function of this office might be establishing liaison with the winning contractor in an effort to place those who need jobs.

***Introduce a legislative package that removes statutory barriers to competition.*** A

legislative package needs to be constructed that effectively removes statutory barriers to competition. DoD needs to throw the full force of its political weight behind this effort. Competitive sourcing can be an attractive political companion for elected officials that believe in a down-sized, cost-effective, performance-oriented Defense Department. Competitive sourcing also brings jobs to the thriving private sector, offering another strong selling point.

In addition to removing legislative barriers, DoD should attempt to revise certain counter-productive features of OMB A-76. For example, the 10 percent in-house cost advantage should be eliminated, allowing competition on an equal footing. New legislation could be introduced that offers an advantage to contractors that retain displaced government employees. The incentive could be tied to the amount saved by avoiding more expensive separation alternatives. These incentives could be extremely enticing, and have no negative long-term implications for the losing activity. This option would not necessarily reduce the short-term monetary costs associated with outsourcing, but would go a long way towards improving morale and productivity by easing the pain and uncertainty felt by employees.

If these recommendations are undertaken, how many more FTEs might be considered for competitive sourcing? It is difficult to determine with precision, but preliminary investigation has been conducted as related in the following section.

## THE FUTURE

This section considers the future of competitive sourcing and attempts to establish a reasonable estimate for additional cost savings beyond the conservatively estimated \$4 billion derived from the 283,000 FTEs in the previous section.

The initial DRID#20 response was a good start, but only a *start*. It demonstrated to OSD where future efforts need to be directed, and allowed planners to confirm or deny hypotheses regarding the mystifying entity called the “Commercial Activities Inventory”. The DRID#20 response was a success in that it put the CA inventory above 900,000—much higher than any previous estimate. However, DRID#20 became a vehicle for the inconsistent application and misinterpretation of manpower criteria and function codes. This, at least partially, accounts for the unbalanced responses, and suggests that further clarification of both procedural and contextual requirements would increase future estimates of the CA inventory and the competent portion of FTEs therein.

The initial response to DRID#20 is encouraging to those who believe additional savings are achievable. DoD organizations have acknowledged that 283,000 FTEs are in fact performing commercial activities that are subject to competition. This response exceeds the DUSD (IA&I)’s initial target that called for competing 237,196 FTEs by 45,804 FTEs.

### *A Conservative Approach*

The defense agencies alone have a combined population of 135,881 FTEs, of which about 41,000 have already been identified as being available for competition. The defense agencies reported about a 15 percent greater population of *inherently governmental* civilian FTEs than did other DoD organizations. If the defense agencies were to classify their civilian populations in-line with the rest of DoD, then an additional 20,000 FTEs could be considered for competitive sourcing opportunities.

As discussed earlier, competing military billets returns the highest cost savings—almost 50 percent on average.<sup>91</sup> This 50 percent figure translates to about \$30,000 in annual savings per military billet competed. Therefore, the identification of additional competitive sourcing opportunities within the military services should produce high pay-off results by increasing the number of military billets competed. A “leveling of effort” across the services could produce an additional 25,000 competable billets.<sup>92</sup> Currently, one service component is planning to compete about 40 percent of its total CA inventory, and the other services are programming closer to 30 percent. Imposing a common required standard is one method of gaining a balanced, more productive response from the services.

The additional cost savings made possible through *leveling* and *balancing* across organizations and functions are significant. By assuming the standard savings rate (31 percent) for defense agency billets competed, and by adopting a slightly-increased savings rate for the military services (35 percent), almost \$1 billion in additional annual

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<sup>91</sup> Center for Naval Analyses, Implementing A-76 Competitions, CAB 96-24 (Alexandria, VA: 1996), 4.

<sup>92</sup> Identity of source is withheld.



savings are possible.<sup>93</sup> This would bring the previous estimate of \$4 billion to about \$5 billion. A quick comparison to the total DRI savings goal of \$6.5 billion suggests that competitive sourcing holds tremendous promise for underwriting modernization programs, even using these conservative estimates.

### *A More Aggressive Approach*

The DUSD(LA&I) Office for Competitive Sourcing and Privatization generated working papers that describe a "Bold New Idea".<sup>94</sup> The Bold New Idea is one possible blueprint for DoD's future competitive sourcing program through FY 2005. This plan builds on the 237,196 billets originally scheduled to be competed. Planners realized that the total CA inventory numbers databased from previous reports (FY 1994 and FY 1995) were well below actual levels. Based on the information available to them in October of 1998 (prior to receiving the DRID#20 input), they felt it might be possible to add another 158,000 FTEs to the original target of 237,196 FTEs. This would bring the total number of FTEs programmed for competition to 395,196 (exceeding the conservative estimate discussed above by 67,196 FTEs). Figure 15 shows the FY 1999 POM targets, the FY 1999 Program Budget (PB) targets, and the additional 158,000 billets that constitute the Bold New Idea. Based on a projected 80 percent competition completion rate, the Bold New Idea would eventually generate \$5.9 billion in steady-state, annual savings.<sup>95</sup>

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<sup>93</sup> [Total Billets X Average Savings per Billet = Average Annual Savings]

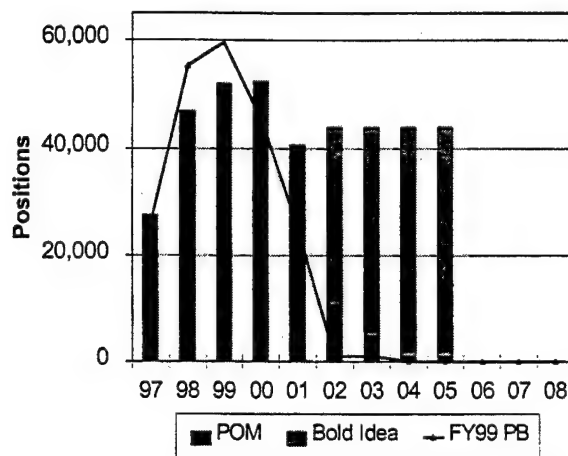
[20,000 X \$18,720] + [25,000 X 21,135] = \$902,775,000

<sup>94</sup> The "Bold New Idea" was formulated in October of 1998, before the DRID#20 responses were submitted to OSD. It does not represent formal policy.

<sup>95</sup> [Total Billets X Average Savings per Billet = Average Annual Savings]

[395,196 X \$18,720] X [.80] = \$5,918,455,296

(Figure 15) "Bold New Idea"



Although the "Bold New Idea" is extremely aggressive, certain factors could contribute to its possible success:

*Strategic outsourcing* opportunities exist for DeCA, DFAS, and DISA—agencies with a combined population of nearly 50,000 FTEs. If DoD outsourcing genuinely embraces the shedding of non-core defense functions, then a careful reexamination of population coding within the defense agencies is required. This examination should entail more than a directive to self-report a population inventory. Difficult decisions need to be made based on how DoD is going to look in the future and these decisions must be integrated with the "Joint Vision 2010" program. The bottom-line criteria should focus on service-performance and savings.

*Additional opportunities exist for the service components* if they are willing to except certain risks and clarify core competencies. These opportunities could produce large numbers if selected combat sustainment functions were outsourced. This approach would require considerable risk-mitigation groundwork, and therefore should be considered as an aggressive method to generate increased savings.

*Another DRID* cycle that is clearly communicated and enforced might identify the bulk of additional FTEs required by the Bold New Idea. Once identified, these FTEs could be competed in such a manner as to maximize cost savings.

*Application of Lessons Learned* Regardless of the total number of FTEs programmed for competition, DoD can maximize cost savings by applying the lessons learned from previous competitions.

It is not very likely that DoD will be able to compete the total number of billets outlined in the Bold New Idea during the FYDP without another DRID cycle. It is, however, very possible that savings could approach those predicted for the “bold” plan. Process efficiencies, larger contracts, increased private sector wins, and possibly competing more military billets could combine to drive cost savings closer to 40 percent. An additional 9 percent in cost savings would increase the conservatively-based \$5 billion to \$5.45 billion—approaching the \$5.9 billion estimate for the Bold New Plan.

**Conclusion** OSD expects the combined results of the QDR and DRI to produce \$6.5 billion in annual savings, of which, \$2.5 billion is slated to come from competitive sourcing. Competitive sourcing alone has the potential of nearly meeting the entire DRI savings goal. Using a very conservative estimation methodology, competitive sourcing yields about \$5 billion in annual cost savings. When more aggressive strategies are employed and combined with effective competitive sourcing that incorporates lessons learned from DoD's recent past, annual savings can approach \$6 billion. Competitive sourcing is the needed insurance policy to guarantee the realization of DoD's force modernization programs.

**Appendix A**  
**OMB Circular No. A-76**

**Policy**

*It is the policy of the United States Government to:*

- a. Achieve Economy and Enhance Productivity.** Competition enhances quality, economy, and productivity. Whenever commercial sector performance of a Government operated commercial activity is permissible, in accordance with this Circular and its Supplement, comparison of the cost of contracting and the cost of in-house performance shall be performed to determine who will do the work.
- b. Retain Governmental Functions In-House.** Certain functions are inherently Governmental in nature, being so intimately related to the public interest as to mandate performance only by Federal employees. These functions are not in competition with the commercial sector. Therefore, these functions shall be performed by Government employees.
- c. Rely on the Commercial Sector.** The Federal Government shall rely on commercially available sources to provide commercial products and services. In accordance with the provisions of this Circular, the Government shall not start or carry on any activity to provide a commercial product or service if the product or service can be procured more economically from a commercial source.

**Appendix B**  
**OMB Circular No. A-76**

**EXAMPLES OF COMMERCIAL ACTIVITIES**

**Audiovisual Products and Services**

- Photography (still, movie, aerial, etc.)
- Photographic processing (developing, printing, enlarging, etc.)
- Film and videotape production (script writing, direction, animation, editing, acting, etc.)
- Microfilming and other microforms
- Art and graphics services
- Distribution of audiovisual materials
- Reproduction and duplication of audiovisual products
- Audiovisual facility management and operation
- Maintenance of audiovisual equipment

**Automatic Data Processing**

- ADP services - batch processing, time-sharing, facility management, etc.
- Programming and systems analysis, design, development, and simulation
- Key punching, data entry, transmission, and teleprocessing services
- Systems engineering and installation
- Equipment installation, operation, and maintenance

**Food Services**

- Operation of cafeterias, mess halls, kitchens, bakeries, dairies, and commissaries
- Vending machines
- Ice and water

**Health Services**

- Surgical, medical, dental, and psychiatric care
- Hospitalization, outpatient, and nursing care
- Physical examinations
- Eye and hearing examinations and manufacturing and fitting glasses and hearing aids
- Medical and dental laboratories
- Dispensaries
- Preventive medicine
- Dietary services
- Veterinary services

## **Industrial Shops and Services**

- Machine, carpentry, electrical, plumbing, painting, and other shops
- Industrial gas production and recharging
- Equipment and instrument fabrication, repair and calibration
- Plumbing, heating, electrical, and air conditioning services, including repair
- Fire protection and prevention services
- Custodial and janitorial services
- Refuse collection and processing

## **Maintenance, Overhaul, Repair, and Testing**

- Aircraft and aircraft components
- Ships, boats, and components
- Motor vehicles
- Combat vehicles
- Railway systems
- Electronic equipment and systems
- Weapons and weapon systems
- Medical and dental equipment
- Office furniture and equipment
- Industrial plant equipment
- Photographic equipment
- Space systems

## **Management Support Services**

- Advertising and public relations services
- Financial and payroll services
- Debt collection

## **Manufacturing, Fabrication, Processing, Testing, and Packaging**

- Ordnance equipment
- Clothing and fabric products
- Liquid, gaseous, and chemical products
- Lumber products
- Communications and electronics equipment
- Rubber and plastic products
- Optical and related products
- Sheet metal and foundry products
- Machined products
- Construction materials
- Test and instrumentation equipment

## **Office and Administrative Services**

- Library operations
- Stenographic recording and transcribing
- Word processing/data entry/typing services
- Mail/messenger
- Translation
- Management information systems, products and distribution
- Financial auditing and services
- Compliance auditing
- Court reporting
- Material management
- Supply services

## **Other Services**

- Laundry and dry cleaning
- Mapping and charting
- Architect and engineer services
- Geological surveys
- Cataloging
- Training -- academic, technical, vocational, and specialized
- Operation of utility systems (power, gas, water steam, and sewage)
- Laboratory testing services

## **Printing and Reproduction**

- Facility management and operation
- Printing and binding -- where the agency or department is exempted from the provisions of Title 44 of the U.S. Code
- Reproduction, copying, and duplication
- Blueprinting

## **Real Property**

- Design, engineering, construction, modification, repair, and maintenance of buildings and structures; building mechanical and electrical equipment and systems; elevators; escalators; moving walks
- Construction, alteration, repair, and maintenance of roads and other surfaced areas
- Landscaping, drainage, mowing and care of grounds
- Dredging of waterways



## **Security**

- Guard and protective services
- Systems engineering, installation, and maintenance of security systems and individual privacy systems
- Forensic laboratories

## **Special Studies and Analyses**

- Cost benefit analyses
- Statistical analyses
- Scientific data studies
- Regulatory studies
- Defense, education, energy studies
- Legal/litigation studies
- Management studies

## **Systems Engineering, Installation, Operation, Maintenance, and Testing**

- Communications systems - voice, message, data, radio, wire, microwave, and satellite
- Missile ranges
- Satellite tracking and data acquisition
- Radar detection and tracking
- Television systems - studio and transmission equipment, distribution systems, receivers, antennas, etc.
- Recreational areas
- Bulk storage facilities

## **Transportation**

- Operation of motor pools
- Bus service
- Vehicle operation and maintenance
- Air, water, and land transportation of people and things
- Trucking and hauling

## APPENDIX C

### Definition of Terms

**Affected parties.**--Federal employees and existing Federal contractors that will or could be impacted by a decision to waive a cost comparison or have submitted bids to convert to or from in-house, contract or ISSA performance, as a result of a cost comparison, and their representatives are affected parties. Agencies or parts of agencies that have submitted formal bids or offers, in order to compete for the right to provide services through ISSAs, are also considered affected parties.

**Commercial activity.**--A commercial activity is the process resulting in a product or service that is or could be obtained from a private sector source. Agency missions may be accomplished through commercial facilities and resources, Government facilities and resources or mixes thereof, depending upon the product, service, type of mission and the equipment required.

**Commercial source.**--A commercial source is any business or other concern that is eligible for contract award in accordance with Federal Acquisition Regulations.

**Contract administration.**--Contract administration includes those inherently governmental activities performed by warranted contracting officers (CO), the contracting officer's technical representatives (COTR), and related payment evaluation staff. Contract administration is not to be confused with contract quality control, performance evaluation or inspection, which are defined as commercial activities by the Supplement and OFPP Policy Letter 92-1.

**Conversion to contract.**--A conversion to contract is the change of performance of a commercial activity from in-house performance by Federal employees to performance by a commercial source.

**Conversion from contract.**--Conversion from contract to in-house performance means the change of a commercial activity from performance by contract with a commercial source to performance by Federal employees with Government resources. It also includes the conversion of expansions and/or new requirements (work) from contract performance to in-house performance.

**Core capability.**--A core capability is a commercial activity operated by a cadre of highly skilled employees, in a specialized technical or scientific development area, to ensure that a minimum capability is maintained. The core capability does not include the skills, functions or FTE that may be retained in-house for reasons of National Defense, including military mobilization, security or rotational necessity, or to the patient care or research and development activities, as provided in Part I, Chapter 1 of the Supplement.

**Cost comparison.**--A cost comparison is the process whereby the estimated cost of Government performance of a commercial activity is formally compared, in accordance with the principles and procedures of the Circular and Supplement, to the cost of performance by commercial or ISSA sources.

**Expansion.**--An expansion is the modernization, replacement, upgrading or the enlargement of an in-house commercial activity or capability. If the expansion involves a 30-percent increase in the operating cost of the activity, a 30-percent increase in the total capital investment to perform the activity or an increase of 65 FTE or more, a cost comparison is required prior to authorizing in-house performance. A consolidation of two or more existing commercial activities is not an expansion, unless the total operating cost is 30 percent greater than the total of the individual components or it requires an increase of 65 FTE or more.

**Exemption.**--An exemption is a determination, made in accordance with Circular A-76 and its supplement, that a commercial activity may be converted to or from in-house, contract or ISSA performance, without cost comparison and may be justified by reasons other than cost.

**Inherently governmental activity.**--An inherently governmental activity is one that is so intimately related to the public interest as to mandate performance by Federal employees. Activities that meet these criteria are not in competition with commercial sources, are not generally available from commercial sources and are, therefore, not subject to Circular A-76 or the Supplement. Guidance to avoid an unacceptable transfer of official responsibility to contract performance may be found in the Office of Federal Procurement Policy (OFPP) Policy Letter 92-1. See Appendix 5.

**Independent Review Officer (IRO).**--The agency official who certifies--prior to bid opening--that the Government's performance and cost comparison estimates have been prepared in accordance with Circular A-76 and its supplement.

**ISSA.**--The provision of a commercial activity, in accordance with an interservice support agreement, on a reimbursable basis. This includes franchise funds, revolving funds and working capital funds.

**Management Plan.**--The Management Plan is the document that outlines the changes that will result in the Government's Most Efficient Organization (MEO) to perform a commercial activity in-house. It provides the staffing patterns and operating procedures that serve as a baseline for in-house cost estimates.

**Most Efficient Organization (MEO).**--The MEO refers to the Government's in-house organization to perform a commercial activity. It may include a mix of Federal employees and contract support. It is the basis for all Government costs entered on the Cost Comparison Form. The Most Efficient Organization (MEO) is the product of the Management Plan and is based upon the Performance Work Statement (PWS).

**National defense activity.**--A national defense activity is a commercial activity that is approved by the Secretary of Defense, or designee, as being subject to deployment in a direct military combat support role.

**National security.**--A national security activity is a commercial activity that is approved by the Director of Central Intelligence, or designee, as being necessary to meet the national security.

**New requirements.**--A new requirement is a newly established need for a commercial product or service.

**Overhead.**--Overhead is included in the in-house estimate and is defined as those costs that are not directly attributable to the activity under study.

**Performance measures.**--Performance measures provide a series of indicators, expressed in qualitative, quantitative or other tangible terms, that indicate whether current performance is reasonable and cost effective. Performance measures can include workload and output-to-cost ratios, transaction ratios, error rates, consumption rates, inventory fill rates, timeliness measures, completion and back order rates, etc. Quality service measures may include responsiveness rates, user satisfaction rates, etc.

**Performance standard.**--A performance standard reflects the minimum, sector-specific, Federal requirement for the performance of a commercial activity. It incorporates both quality measures and cost measures. Cost measures reflect the cost comparability procedures of Part II of this Supplement to assure equity in the comparison of performance standards with private industry standards.

**Performance Work Statement (PWS).**--A Performance Work Statement is a statement of the technical, functional and performance characteristics of the work to be performed, identifies essential functions to be performed, determines performance factors, including the location of the work, the units of work, the quantity of work units, and the quality and timeliness of the work units. It serves as the scope of work and is the basis for all costs entered on the Cost Comparison Form.

**Post-MEO performance review.**--When services are performed in-house, as a result of a cost comparison, including those involving an interservice support agreement, a formal review and inspection of the Most Efficient Organization (MEO) should be conducted. Typically, this review should be conducted following the end of the first full year of performance. Post-MEO Performance Reviews confirm that the MEO has been implemented in accordance with the Transition Plan, establish the MEO's ability to perform the services of the PWS and confirm that actual costs are within the estimates contained in the in-house cost estimate. Adjustments may be made for formal mission or scope of work changes.

**Performance requirements summary (PRS).**--A PRS is a synopsis of the scope of work and output performance measurements that may be used in conjunction with aviation cost comparisons that rely on the GSA FAMIS data system for identifying contract costs.

**Privatization.**--Privatization is the process of changing a public entity or enterprise to private control and ownership. It does not include determinations as to whether a support service should be obtained through public or private resources, when the Government retains full responsibility and control over the delivery of those services.

**Quality assurance surveillance.**--Quality Assurance Surveillance is the method by which Federal employees will supervise in-house or contract performance to ensure that the standards of the PWS are met within the costs bid.

**Reasonable or competitive prices.**--The expected range of prices resulting from experience obtained through the competitive free enterprise system for like or similar activities. Determinations are to be made by the contracting officer.

**Recurring commercial activity.**--A recurring commercial activity is one that is required by the Government on a consistent and long term basis. This definition does not imply an hourly, daily, monthly or annual requirement, but must, in a general sense, be repetitive in nature, wherein the expected workload can be reasonably estimated.

**Sector.**--Certain commercial activities are common to more than one agency. Many of these commercial activities can be aggregated. For example, an agency may inventory transportation acquisition, operations, maintenance and disposal as independent commercial activities.

**Severable expansion.**--A severable expansion is an expansion of currently contracted, in-house or interservice support agreement provided work that could be provided using the current approach or could, without severe additional administrative burden, be provided by another competitive offeror. Economies of scale are not justification for dismissing new or expanded work as severable, these economies will be tested through competitive offer.

**Start date.**--This term is used in two ways. First, it is the date when a cost comparison begins, generally defined as the date that a local Study Team is formed and actual work on the Performance Work Statement, Management Plan and in-house cost estimate begins. Second, it may refer to the actual date work is scheduled to begin under a contract, as provided in the solicitation.

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